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Housing, Pension, Justice, Hegedüs József (Economist)

These days, few serious economists oppose the introduction of a real estate tax in Hungary on theoretical grounds. However, the decision is in the hands of politicians concerned with getting as many votes as possible on the short term. It is therefore to be feared that, as it so often happens in immature democracies, politicians will not be capable of introducing a modern tax. This article aims to somewhat improve the bad odds of such reform passing.

The social and economical consequences of a real estate tax cannot be analyzed without taking the relationship between the Hungarian pension system and real estate assets into account.

Pension systems are in crisis worldwide, but this crisis will have a particularly strong effect on Central and Eastern European countries, Hungary among them, as the accelerating process of aging will appear at a much lower level of GDP than in developed countries. The search is on for a fourth pillar of the pension system, which refers to possible ways of financing pensions other than the traditional three pillars (social or minimum pension financed through taxes, systems based on compulsory and on voluntary contributions) recommended by the World Bank. Possibilities include support through informal networks or target-oriented healthcare and housing programs. Among these reform proposals, the inclusion of households' real estate assets as the fourth piller of financing is what we find the most exciting. (The EU is currently funding comparative research ('DEMHOW') on this topic, which concentrates on the connection between demographic changes and real estate assets in 8 European countries, including Hungary.)

Sociologists have long claimed that real estate assets could play an important role in the support of the elderly. Several people have proposed that the indirect aim of housing policy which favored private property could have been to shore up the pension system, as the elderly can relieve their financial difficulties more easily by freeing up some of their real estate assets, if the appropriate modern financial products are available. In the case of socially based pensions, ownership of real estate assets forms part of the distribution criteria, excluding those with large real estate assets from socially based pensions.

How is the situation in Hungary? Housing privatization and housing policy which favored home ownership has led to private ownership of 96% of the housing stock in Hungary. Real estate assets make up 2/3 of households' assets, and this proportion has only grown as a consequence of the crisis, since the value of stocks and investments has decreased at a much greater rate than that of homes (home prices have not yet fallen drastically). Could real estate assets play a role in the private or public financing of provisions for the elderly? Households with low income but significant real estate assets appeared en masse as a result of privatization in Eastern European countries. A World Bank study proposed in the 90s that a special financial product should be developed to support such households. This product is called reverse mortgage, and it is not a new invention.

Annuity in return for tenancy or ownership right, a contract among private persons, were popular products before the change of the regime, especially in the public rental sector. They turned the tenancy right into an annuity and/or a care service. Housing research has shown that elderly pensioners living in the inner city of Budapest supplemented their income by renting out empty rooms. In 1997, the Hungarian Parliament proposed the development of a financial product, perhaps with state support, which would allow low-income pensioners to supplement their income at the expense of their real estate assets („home for annuity" program). The MFB (Hungarian Development Bank) had a feasability study made, which estimated the size of the market as very small (4-19 thousand) and the expenses as very high, which meant that the state program was never introduced. Innovative local governments made such a product, but they were only able to form a clientele of a few hundred. The 2001 Hild apartment annuity program was more important, and it was agressively present on the advertising market. This was followed by products of FHB and OTP (with an estimated size of 4-6 thousand contracts).

What happens with the real estate assets of the elderly? Why do needy pensioners not use the possibilities in real estate assets? Primarily because the decision is typically made together with the larger family, in which inheritance is an important factor. Hungarian housing sociology has determined that the behavior of households on the housing market is influenced by the larger family (primarily parents and children living separately). Parents support their children in buying an apartment, selling or trading their homes if necessary. At a later point in their life cycles, the housing market movements of the elderly are motivated by proximity to the children, and apartments are often formally owned by the children to evade estate taxes. In the period of mass privatization, the sitting elderly tenants bought their apartments for their grandchildren who – according to the law – should have been registered as the owners of the apartment. The elderly do not free up their real estate assets, because they their families offer them something of „greater value" – a guarantee of love, support and help in return for inheritance. Families naturally do not ponder the options so coldly and rationally, but these unspoken and unwritten considerations are in the background of their behavior.

Intergenerational transfers play a very important role in the conservation of social inequalities. The possibilites of the young are to a large extent determined by family background. The property tax is meant to moderate inherited social inequalities. By recently partially abolishing this tax, Parliament has succeeded in maintaining inequalities.

The current welfare system attempts to carefully integrate families into the finance of social services for the elderly partly by proscribing parental support, and partly by putting a lien up to the expenses of care on the real estate of the elderly. To enter a high level nursing home presupposes the use of the savings (or real estate) of the elderly. A further example of real estate assets being drawn into the social system is the management of arrears with the maintanance fee in condomiums. Debt accumulated through arrears can be put as a lien on the real estate. It would be good if the state program would help finance of the cost of non-payment. The importance of the real estate tax apart from the already known facts (the palpable part of wealth created through secret income is included in taxation, taxation becomes more equitable etc.) is that it works against the conservation of social inequalities. If an older household has no income, or decides that the tax is unpayable, then the tax authority puts a lien on the real estate or the family (the future owner) contributes towards the taxes. (It is also possible to move into a less expensive apartment.)

In ten years, employees declared to be on the minimum wage will be retiring in great numbers. Their pensions will certainly need to be complemented. The source of the supplements could be precisely the income from tax savings, invested in real estate. Through the estate tax, society recovers part of the unpaid taxes.

What hapens to those, who payed taxes appropriately? They will fare relatively badly, but still better than if they had to pay the pensions of the „free riders”. To the moralizing argument, that it is „immoral to tax the fruit of a life's worth of work”, we can answer, that the worth of real estate (the object of the tax) is determined by at least three factors: the family savings (including their own work), state subsidies and market forces. The real estate tax applies to all three factors. And there is justice in society's leveling the advantages of state subsidies (gains from privatization, loans with reduced interest rates etc.)