LABOUR MARKET TRENDS
IN HUNGARY, 2004

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INTRODUCTION

In 2004 Hungary made some steps to return to the path of sustainable economic growth. In transforming economies, the incalculable political decisions usually make the evolution of the economies more difficult, Hungary is a typical example of this. We can highlight three major periods in the trend of the Hungarian economy, as well as of the labour market:

3. Slowing economy and deepening inequilibrium (2001–).

The first period can be characterized by the structural transition: the unemployment came to the surface, there was a sudden drop of employment, which at the end of the period began to rise slightly. First the GDP sharply decreased then started slowly increasing, and with the exception of 1994 (year of elections) and 1997 net real wages declined all along. The second period coincided with relatively high GDP growth, positive but lower growth rate of real earnings and a slightly more intensive increase in employment. In the third period, employment appears to stabilize and become fixed around an – by international comparison – extremely low rate of about 50–55 per cent.¹

1. LABOUR FORCE ACTIVITY

After a slight increase in employment, from 2004 Hungary has again fallen to the 2000, 50 per cent employment level. The drop is mainly due to the change in the absolute number of jobs. At the same time, inactivity jumped up only temporary, and now seems to be stabilizing at around 46 per cent, which is extremely high. The decrease in employment, however, seems to precipitate in unemployment: the 1 per cent fall in employment rate resulted in a 1 per cent growth in unemployment rate, though this latter index, with its value of 6.1 per cent, is still low by international comparison. However, according to the latest data of the first quarter of 2005, unemployment has risen another 1 per cent to 7.14 per cent. Besides the extremely low level of employment, due to the great number of inactives, which is a well-known problem in Hungary, we face again, at the beginning of 2005, the possibility of growing unemployment.

¹ Among the population aged between 15 and 74.
1.1 Employment

In comparison with the European Union Hungary lags behind as far as labour market activity is concerned. The former fifteen member states of the Union have an average of about 10 per cent higher employment rate than Hungary (CSO 2005a). Even the less developed countries do some several per cent better. The unemployment rates do not differ significantly, so that the underlying problem is still the particularly low level of labour market participation, as this determines the competitiveness of a country.

Considering a comparison among the Visegrad countries, the performance of Hungary is still rather low. Hungary has an employment rate (56.8 per cent) higher than Poland’s (54 per cent), and a bit weaker than Slovakia (57.6 per cent) (CSO 2005a). However, the Czech Republic is doing much better: their employment level competes with the midfield of the EU–15 (64.4 per cent).

1.2 Unemployment

After the transition in 1989, Hungary was suddenly faced with rapidly growing unemployment. The peak was more than 12 per cent in 1993, the rate then slowly but surely decreasing until 2002 when the trend again reversed.

The unemployment rate is characterized by strong seasonality: it is higher in winter, and is lower in summer. In addition, the latest data show an increase in the adjusted trend also, the average number of unemployed in Hungary was 6.1 per cent in 2004, and has an upward tendency. While the low rate of employment means low competitiveness, the high rate of unemployment rather means more serious inequilibrium. While the past years were characterized by a low rate of employment and a low rate of unemployment, the latter index is now slowly approaching the EU average (which is above 7 per cent) (CSO 2005a).

Moreover, there is a slight growth in the average duration of unemployment. While in 2003 the average duration was 16.5 months (which is still very high), in 2004 it grew to 17.7 months (CSO 2005a). This tendency also makes difficulties in the decrease of the inactivity rate: those, who cannot find a suitable job in a given period can easily decide to leave the labour market. In addition, it is an indication of the change of the structure of unemployment; the longer the duration, the higher is the non-frictional unemployment.

The 180 degree turn in the tendency of unemployment is partly caused by a global recession, and it is hard to prove that it has any Hungarian characteristics or if we converge to the “European natural rate”. Later in this section, we will try to put special emphasis on this question.

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2 The Hungarian rate is still a bit smaller than that of the EU–15.
3 Among the population aged between 15 and 64, in 2004 – third quarter of the year.
4 Among the population of working age (men: 15–59; women: 15–54).
1.3 Inactivity

The top priority for the labour market policy should be to help the inactive population of working age to return to the labour market. The Hungarian activity rate is really low by international comparison, which weakens the country’s competitiveness, and causes other long term social problems.

The gender gap in labour force activity is spectacular (see Figure 5), we will analyse it further. The other important issue that needs to be discussed is the willingness to work of the inactive group. The vast majority of this large group do not even intend to work. This, per se, is not a problem, as pensioners, students and people on maternity benefit aged between 15 and 74 are involved here. A greater problem is that, for example, people working in the black economy are also involved here; they should be made to return to the legal labour market. (See later.) The ratio of the so called hopeless unemployed points out the most serious problem of inactivity: these people would like to work but do not search for a job because they think they would not find one appropriate for them. The number of these is of the order of 100,000 and in Figure 1, we can see that the proportion of them among the inactive population has grown somewhat, more among men than among women, which tendency should not be unobserved by policy makers.

Figure 1: Ratio of hopeless unemployed to the number of inactives, 2003 and 2004

2. LABOUR FORCE PARTICIPATION BY DIFFERENT DIMENSIONS

In the following paragraphs we break down the labour market aggregates by different dimensions and try to point out which of these are the most responsible for the changes, and which of these should draw the attention of labour policy.
2.1 Age and education

One major problem is revealed by looking at the diagrams of labour market status by age (Figure 2, 3). Our impression is ambivalent. On the one hand, we can see that the employment of the elderly (population aged between 60 and 74) is rising and the unemployment and inactivity of the same age group is declining. This might signal the normalization of the labour opportunities of the elderly: there are jobs created for “active” people beyond the working age and that treating unemployment by allowing the elderly population to retire before the commencement of the retirement age is becoming unnecessary. This is good news as after the transition governmental policy had no choice than to try this. Another less positive reason for the increasing level of elderly employment, however, is to do with the raising of the retirement age, which was unavoidable in order to maintain the retirement system mainly over the short term.

![Figure 2: Unemployment rate by age, total population](image)

![Figure 3: Quarterly change of employment, by age](image)
Besides the positive tendencies of the elderly, however, the employment of the youngest (population aged between 15 and 24) has fallen some 6 per cent during the past two years, while their unemployment rate is increasing heavily (from about 14 per cent to almost 19). These facts draw a severely pessimistic picture of the young career starters.

What makes this picture more serious is that most of these career starters are, almost certainly, of a relatively low education level. Taking a look at the labour market status broken down by education we gain evidence of an additional problem relating to the previous one (Figure 4). As a clear piece of evidence of the knowledge-based society, the unemployment rate among those with at most primary school education is double that of the average (in the first quarter of 2004 it was 12.67 per cent vs. 6.09 per cent; in the first quarter of 2005 it was 14.22 per cent vs. 7.14 per cent) and is increasing.\(^5\) What is striking is that people of less than secondary school education are far more exposed to unemployment than those of a higher education and even than those of the average.

**Figure 4: Unemployment rate by education**

The greatest problem with the young unskilled, however, might go further. Though we do not have appropriate data, these layers might be the ones where the number or proportion of the “other inactives” (that is not students\(^6\) and not individuals on child care allowance) is the highest. The characteristics of these might be that they want to work but can not find a job appropriate for themselves or are not satisfied with the wage they could earn. Therefore, they tend not to enter the legal labour market and search for alternative working opportunities in the black economy. In the long run, making them come back to legality may be a real challenge as...
it is often hard for white economy employers to compete with black wages. Taking into account that according to a European Union estimate the proportion of the black economy was about 16–17 per cent of the GDP around the millennium in Hungary, and that with this Hungary is among the leaders in this aspect in the EU–25, the problem merits more attention (FMM 2004; Sík 2000).

![Figure 5: Employment and unemployment rate by gender](image)

2.2 Gender gap

Figure 5 suggests that the employment rate of men is about 15 per cent higher than that of women, and the situation is just the opposite as far as inactivity is concerned. There has been a long debate whether this huge difference is mainly due to women’s discrimination in the labour market or to the gender specific preferences regarding the propensity to work.

A problem of great importance seems to be, however, the significant and continuous rise of women unemployment: while men’s unemployment shows a strong seasonality, and the adjusted path looks stable, the data for women give cause for serious concern (Figure 5). Their unemployment rate has been constantly rising since the second quarter of 2003 (from 5.4 per cent to 7.3 per cent in one and a half years).

Slight but qualitative differences can be captured looking at the time series of employment and inactivity by gender. In the case of men we again see strong seasonality but approximating the path by a trend of moving averages no significant change is observed. In absolute terms, it is not a cause for joy, of course, as it signals the stagnation of the economy. In the case of women, the tendencies are more positive, although it also seemed to stagnate during the previous year: the slightly growing employment seems to absorb the decline in inactivity though in fact unemployment has been seriously rising.

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7 Though in the first quarter of 2005 the number of unemployed jumped by 1 per cent compared to the previous quarter.
2.3 Sectoral breakdown

Looking at the break down of the different sectors, only one significant change has occurred: after the public sector wage raises the share of public employment among all the employed started increasing slightly and from the second quarter of 2004 reversed. In absolute numbers this means an overall employment increase of 20,000 people in the public sector while in the private sector employment declined by some 7,000 people. This is surprising as it is widely known that in Hungary the size of the state bureaucracy is relatively large, which is valid also in the context of the number of the employed in the public sector. Cutting back the staff was planned for efficiency reasons and also to signal the state’s intention to pull back from the economy. This perception does not seem to have been successful as the number of employed in the public sector – partly due to the wage rises – quickly grew back to the original level.

The share of agriculture and industry from total employment maintains a slight decline: during the past two years the employment share of both has fallen 0.6 per cent, so that at the beginning of 2005 less then 4.8 per cent of the working population made their living from agriculture and 32.7 from industry. At the same time, from the point of view of the number of unemployed by former work, the number of those losing their jobs in the service sector is growing the most heavily. In this aspect agriculture and – by another dimension – the public sector is stable; at the moment it is in the private sector where most people lose their jobs. (While among the employed 72–73 per cent work in the private sector, 82 per cent of the unemployed worked previously in the that sector. Moreover, the number of unemployed previously working in manufacturing has particularly increased – by some 24 per cent [CSO 2005a].)

Not surprisingly in a transition economy, the employment of blue-collar workers is declining in favour of the white-collar: blue-collar workers, those typically with lower education and skills, can witness the depreciation of their human capital and need to retrain themselves. Assisting with this, by active labour market programs, is an important priority of the governmental labour policy and as labour market and labour force is an accentuated field of European Union policy as well, Hungary also shares in European subsidies supporting the roll back of unemployment and inactivity. (See Frey 2004 for details.)

2.4 Regional differences

Even labour market aggregates can show that Hungary is sharply divided into two parts and these differences do not seem to be diminishing (Figure 6). The data of the first quarter of 2005 suggests that the separation might become even worse: the eastern regions of Hungary might divide
into two further parts, with Northern Hungary and the Northern Great Plain falling behind. These two regions are the ones which suffered the most at the transition and could not cope with the sectoral transformation and the declining industry. A major part of the population worked in the industrial sector as blue-collar workers and for them the problem of the deprecating human capital was more sharply felt. From a distance of 15 years these difficulties are still visible and are becoming relatively more and more significant. These regional differences put a terrible burden on the regional development policy of Hungary because if the situation is left unchanged these regions will become completely uncompetitive in the European Union.

Figure 6: Employment rate by region, 2000–2005

![Graph showing employment rate by region](image1)

Figure 7: Sectoral transformation by regions, 2004. I. – 2005. I.

![Graph showing sectoral transformation by region](image2)
Figure 7 illustrates the change in employment level by sector in the first quarter of 2004 and 2005. In the figure we can discern that in most regions (with the exception of Western Transdanubia) opportunities in agriculture are limited and declining while the emergence of the service sector has hardly started. The unsatisfying and decreasing development of industry is also significant, and might be due to high taxation and the considerably increased wage costs caused by the 2001–2003 wage rises. Looking at the bars of Northern Hungary and the Northern Great Plain gives cause for serious concern. Here, large numbers of the low skilled and an underdeveloped infrastructure deter investments and this stagnation can only be reversed by governmental help.

3. WAGES

In 2004 Hungary took some steps to return to the sustainable path of economic growth, which in part needed to involve a discrete wage policy. In this chapter we will focus on the previous years’ wage-trends, the sharp increase due to the wage rise in the public sector in 2002, and the sharp decrease in 2004.

Figure 8: Growth rate of real net wage and GDP, 1991–2004

Figure 8 shows the annual growth rate of net real wages and GDP between 1991 and 2004. The first of the three major periods already mentioned, transformation and the stabilization package (1990–1997), can be characterized by decreasing GDP and continuously decreasing net real wages. The second period, the boom in the Hungarian economy (1998–2000), coincided with relatively high GDP growth and a positive but lower growth rate of real earnings. In the third period, of a slowing economy and deepening inequilibrium (2001–2003), as the figure suggests, wage rises were unsustainably high.
Economists widely agree that the major problems of the Hungarian economy following the millenium were the downturn in the external economic environment; instead of export, there existed an internal demand driven economy and an unsustainably high growth rate of wages, mainly due to wage rises in the public sector in 2002 (which extended to 2003) and partly to the rise of the minimum wage in 2001 and 2002.

These macro level problems, which strengthened the effects of each other, were the main causes leading to the current situation: The former 5.2 per cent GDP growth in 1999 dropped to 3 per cent in 2003 and 4 per cent in 2004, while the former 13.6 per cent (sic!) growth of net real wages in 2002 decreased to –1 per cent in 2004.

3.1 Sectoral differences

The correlation between the GDP and real wages is surprisingly low in Hungary, which can be explained by the relatively large part played by the public sector where wages are mainly set by political interests.

In Figure 9 we can see the growth rate of real wages in the public and private sector between 2000 and 2004. This period was characterized by a relatively big variance of public sector wage growth, which strongly correlated with the private sectoral one. The linear model which represents the connection between the upper variables has \( R^2 = 0.7 \), which is a really strong correlation: The public sector wage settings, which are mainly politically and not economically set strongly affect the wages in the private sector. The significantly increased wage level could be responsible for the worsening labour market indices (that is to say, for growing unemployment and decreasing employment). That is why the labour market downturn might partly be a Hungarian characteristic, a long run consequence of the minimum and public sector wage rise and is not solely due to global recession.

In 2003 the slowing economic growth and the increasing budget deficit forced the Hungarian government to change its labour market policy. The measures were postponed and the results surfaced only in 2004. The last year was characterized by continuously decreasing real wages in the public sector (5 per cent on average) and barely increasing real wages in the private sector (1.1 per cent on average), which means a total 1 per cent real wage-cut in the economy.

Transforming countries are usually characterized by incalculable political decisions; Hungary unfortunately is a good example of this: The government seems to rather slow down economic development. The effects of the public sector wage rises are really spectacular, while the previous political measures, the rise of the minimum wage in 2001 (by 60 per cent!) and in 2002 (by another 25 per cent reaching 50,000 HUF) are not that

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8 The sources of data all along this subsection are CSO (2004b) and CSO (2005b).
9 \( y = 0.2974x + 2.9122 \);
\( R^2 = 0.7022 \)
evident. The value of the minimum wage compared to the gross average significantly grew in that two year period by up to 40 per cent, which was never seen before. In 2003 no rises were given, but in 2004 (by 6 per cent to 53,000 HUF), so the real value of the minimum wage has decreased in the past two years.

Figure 9: Growth rate of real net wage in the public and private sector

The average gross and net earnings by industry in 2004 highlight that the wage freeze in the public sector were global: nominal wages hardly increased in the health and education sectors and in public administration (so that the real wages decreased), while in the private sector the average nominal wage growth was marginally above the consumers’ price index.

In the private sector the nominal gross and net wage growths were the highest in the financial intermediation sector (18.4 per cent – 16.4 per cent), and the lowest in the hotels-restaurants sector (3.5 per cent –3.9 per cent). Data evidently show, however, that the highest and lowest wage levels are in the same sectors: the conclusion is that wage inequalities have increased in 2004.

The gross wages increased more considerably than net wages (6.1 per cent – 5.7 per cent on average), which means that wages were overall more taxed in 2004 than in 2003. On the one hand this fact is surprising as the personal income tax rates decreased from 2003 to 2004\(^\text{10}\) and also sets back job creation and the growth of employment, while on the other hand, taking the serious budget deficit into account, the phenomenon is not surprising.

The growth rate of net wages in the white collar-blue collar comparison shows that overall blue-collar workers became better off (6.2 per cent compared to 5.2 per cent), while in the previously mentioned financial intermediation sector the opposite tendency took place (5.3 per cent – 16.4 per cent).

\(^{10}\) In 2003 the rates of the three-step personal income taxation were 20, 30 and 40 per cent while in 2004 they were decreased to 18, 26 and 38 per cent. (http://www.apeh.hu/informacio/sav.htm)
3.2 Regional differences

A previous chapter came to the conclusion that Hungary is sharply divided into a more and a less developed part in the context of economic activity. Figure 10 shows that regarding the earnings and their growth rate, the situation is more complicated. In Central Hungary the gross and the net wage level and earnings are about 40 per cent higher than in the average of the other regions, while in these other regions the wage rates are more or less similar. The growth rate of the factors mentioned supports our previous suspicion that the wage inequilibrium deepened in the previous year: the two regions with the lowest earnings level had also the lowest growth rate. What is more, we can see that regions with the worst employment situation are among those with the worst earnings possibilities (Northern Great Plain, Northern Hungary, Southern Great Plain, Southern Transdanubia), and the best is the best from both points of view (Central Hungary).\(^1\) We conclude that higher wages coincide with higher employment. Economists might puzzle as to why the law of demand and supply does not solve this anomaly: people living in low employment and low wage level regions should move to live in high employment and high wage level regions. Hence the labour supply surplus would force down wages, while in the regions from which people have moved the lack of a labour force would push up wages.\(^2\) This way migration would solve the problem.

Figure 10: Total earnings and the growth index in the 7 regions of Hungary, 2004


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\(^1\) We again gain evidence of Hungary being extremely concentrated in the centre with the capital, Budapest.

\(^2\) Of course, by this, we implicitly assumed that the migration causes labour force deficit in the underprivileged regions, which is not necessarily true.

\(^3\) According to the data of the 2001 census, a marginally more than 1 per cent of the population migrated between counties and only less than half of the migrants were active on the labour market. (EUROSTAT)

Nevertheless, the huge gap between the more and the less developed part of Hungary does not seem to diminish and the relatively low rate of domestic migration\(^3\) also helps to maintain this difference. The main causes behind this fact are the regional differences between the prices of real estates and the low level and costliness of flat-renting and are of a cultural nature. As
far as flat-renting is concerned, it is not common practice as Hungarian social culture has the ethos that everybody should have his/her own flat and therefore the ratio of tenant-owned flats is particularly high.\footnote{14 See also Cseres-Gergely (2003).}

In a word, Central Hungary is definitely the engine and the most booming region of the Hungarian economy at the moment, but the increasing inequalities cause associated political and economic problems and tensions that need to be solved.

4. MIGRATION AND THE EUROPEAN UNION AS AN OPPORTUNITY

On 1\textsuperscript{st} May, 2004 Hungary entered the European Union. The population has positive expectations for a change in the standard of living, in which labour prospects and earnings play a key role. In the following paragraphs we make an attempt to surmise concerning the effect accession will have on the Hungarian labour market.

The general tendency among the less developed EU member states is that both their employment rate and their wages converge to the Union average by some measure. This convergence can be faster and may exceed the average (e.g. Ireland) while in other cases (e.g. Greece) can be much slower and it may even be doubtful whether we can call it a “convergence”. The Hungarian path is similar to that of Spain and Belgium and is definitely among the worst. However, we must not forget that in 1994 Ireland had almost exactly the same employment rate as Hungary and that the more developed regions of Hungary are close to reaching the average of the Union (\textit{CSO-Stadat}). Therefore, to move closer to the European level the development of Eastern Hungary is crucial. The improvement of infrastructure, taxation benefits (in times when the budget deficit can afford it) alone could work wonders in attracting investments and Hungary could follow the Irish path. A pessimistic scenario would emerge if the segregation of the two parts of Hungary were not to diminish and this would act as a block on the aggregate closing of the gap by Hungary. Unfortunately, our data up to the present supports this outcome.

Looking at accession from another point of view, there are some worries that because of wage disadvantage foreign migration will become more intensive and highly qualified people (who are definitely more mobile) will flow out to the west. Fóti (2000) sums up the results of some surveys. According to one survey from 1996, 20 per cent of the population considered the possibility of migration, only half took some concrete steps but the effective migration potential (the proportion of those applying for working permission or right to abode) is lower than in other Central European countries (below 1 per cent). At the same time, some two years later the ratio of effective migration potential in Hungary was already at 3 per cent. In the ’90s Hungarian surveys and a survey made for the European Com-
mission found that 6 per cent of the population were considering leaving
the country, which was, however, 1–2 per cent higher than in the neighbour-
bouring countries. The majority of these people consider a relatively short,
1–3 year stay in order to obtain higher wages, better job opportunities and
are highly qualified, young men. (Főti 2000) Unfortunately, no up-to-date
data was available for us to see the present tendencies, that is to say, after
accession to the Union. The potential might have increased significantly,
nevertheless, as Főti (2000) also mentions, foreign migration has its own
rational and cultural determinants so just as internal migration is relatively
low in Hungary, foreign migration may not change dramatically neither.
From all this and from the above data, we conclude that the most likely
scenario at the moment is that Western Hungary will rapidly move closer
to the European standard both in the aspect of employment and wages
while the eastern part can easily fall behind. This puts a terrible burden on
regional development policy (involving labour and social issues) and might
cause serious budgetary tensions between the short and the long run, which
can not be completely bridged by European Union sources and subsidies.

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