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*Gábor Kézdi,
Hedvig Horváth and
Péter Hudomiet*

Labour Market Trends, 2000–2003

Abstract

The paper reviews the most important labour market trends of the past three years in Hungary. It relies on aggregate data and research studies. Its goal is to highlight the most important problems of the Hungarian labour market. It focuses on three major points. First, looking at trends in employment, unemployment and non-participation, we discuss what may be the causes of the slowly increasing but still very low level of employment. We find that the most important problem of the Hungarian labour market is long-term discouraged unemployment, which has structural causes. We analyse the regional and sectoral trends in employment. We document the deep regional divide within Hungary, which further increased in the recent three years. Second, we look at what might have caused earnings growth outpacing economic growth in the past few years. We discuss the effects of two significant policy measures: the increase of the minimum wage in 2001-2002, and the increase of public sector wages at the end of 2002. Third, focusing on the returns to education, we find that the Hungarian labour force, on average, is still unskilled rather than overqualified.

Keywords? Hungarian labour market, employment, minimum wage, public sector wages, returns to skill

JEL Classification: J0, P23

Authors:

GÁBOR KÉZDI is an economist, Lecturer at Corvinus University of Budapest; Research Fellow at the Economics Institute of the Hungarian Academy of Science. Research interests: labour economics, econometrics.

HEDVIG HORVÁTH is a student at Corvinus University of Budapest.

PÉTER HUDOMIET is a student at Corvinus University of Budapest.

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Gábor Kézdi, Hedvig Horváth and Péter Hudomiet

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Introduction

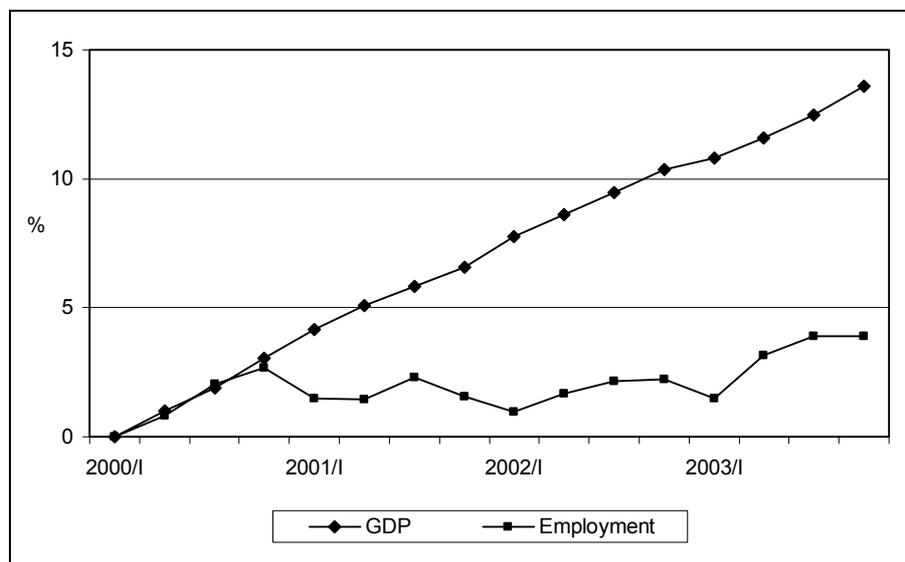
This study reviews the most important labour market trends of the past three years in Hungary. Being a review, it does not contain many new results. Instead, its goal is to highlight the most important problems of the labour market. In order to achieve that goal, we rely on publicly available aggregate data and research studies.

After the introduction, we look at trends in employment, unemployment and non-participation. We then discuss what may be the causes of the very low (albeit slowly increasing) level of employment. We find that the most important problem of the Hungarian labour market is that of long-term hopeless unemployment (showing up in the data as non-participation), which has structural causes. In the third Section we analyse the regional and sectoral trends in employment. We document the deep regional divide within Hungary, which has further increased in the past three years. In the fourth Section we look at earnings and discuss the components of earnings growth, which has outpaced economic growth in the past few years. Sections five and six discuss the effects of two significant policy measures: the increase in the minimum wage in 2001–2002, and the increase in public sector wages at the end of 2002. At the end of the paper we look at the returns to education. Although, by some measures, the Hungarian workforce is now somewhat overqualified as a result of expanding higher education, we find no evidence of falling returns. The available evidence suggests that the Hungarian labour force, on average, is still unskilled rather than overqualified.

Employment, unemployment, and non-participation¹

Hungarian employment lags behind the European Union average: at the end of 2003, 51 per cent of the Hungarian adult population (aged between 15 and 74) was employed—compared to the 60 per cent EU average (HCSO 2003c). At the same time, the Hungarian employment rate has increased in the past four years: in 2000 it was below 49 per cent. The increasing employment rate is primarily due to an increase in employment in absolute terms: in other words, active job creation. A decreasing population has also contributed to increasing employment rates, but its contribution is significantly smaller.

Figure 1: *Quarterly growth of GDP and employment, 2000–2003 (%)*



Source: Employment: HCSO (2003d); GDP growth: HCSO–Stadat (2004).

The modest increase in employment has coincided with a dynamic (although gradually slowing) economic growth. Between the start of 2000 and the end of 2003, Gross Domestic Product (GDP) rose by almost 14 per cent (HCSO data 2004). During the same period the increase in employment was barely four per cent (see *Figure 1*).² The fact that employment grew at a signifi-

¹ Unless otherwise indicated, the source is HCSO (2003d).

² While GDP growth slowed down—though it remained positive—the path of employment was truly variable: during 2000 it increased almost three per cent, then it stagnated, fell a little until 2003, and started rising again in 2003. Seasonal effects are important: employment

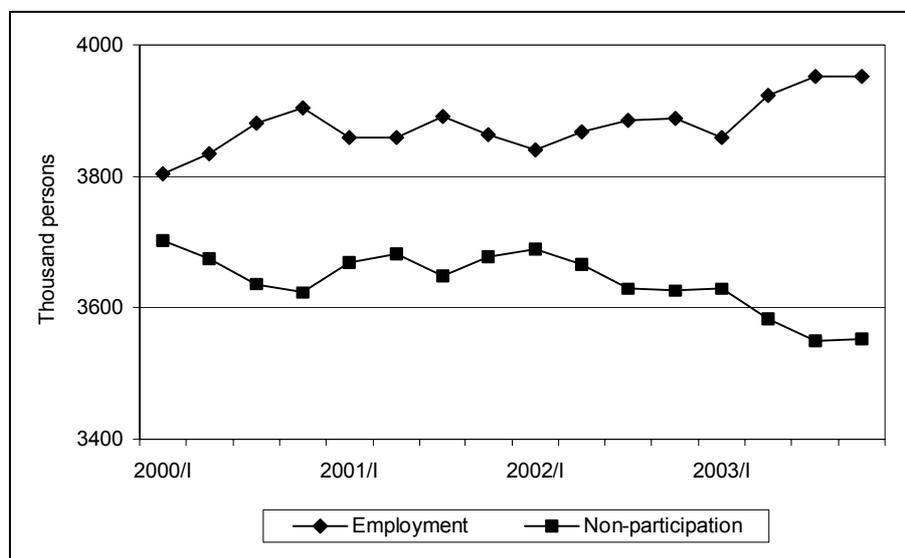
cantly slower pace than GDP implies that economic growth did not benefit a significant part of society. At the same time, however, it also reveals improving productivity, an essential element for long-term growth.

By the middle of 2002 the number of unemployed had decreased (at a slowing pace), from 275 thousand to 230 thousand (the unemployment rate fell from 6.7 per cent to 5.6 per cent). However, the trend went into reverse in 2002, and by the beginning of 2003 unemployment had reached the same level as in 2000. Since then unemployment has returned to its low level of 2001: at the end of 2003, 232 thousand people were unemployed and looking for work in Hungary, which meant a 5.5 per cent rate of unemployment—compared to the seven per cent EU average (HCSO 2003c).

According to the standard definition, an unemployed person does not currently have a job but is actively searching for one, and would be able to start working immediately if the opportunity arose. In Hungary, the number of registered unemployed is approximately one and a half times the number of unemployed according to the standard definition. A plausible explanation for this phenomenon is hopeless unemployment: the possibility that, besides the unemployed actively searching for work, there are plenty more out of the labour market who would probably search for jobs if they did not find their prospects hopeless. These so-called ‘passive’ unemployed may experience more acute problems than the ‘active’ unemployed. Significant ‘passive’ unemployment implies that unemployment is still strongly structural.

The trend in employment runs counter to the change in non-participation, i.e. those withdrawn from or driven out of the labour market (pensioners, students, the hopeless unemployed, etc.) (see *Figure 2*). Since 2000, both the absolute number of non-participants and the rate of non-participation have decreased (though not continuously) by some 150 thousand and one percentage point, respectively (from 3.7 million to 3.55 million, and from 47 to 46 per cent). It is still high by comparison with other countries. *The most important labour market problem Hungary faces today is not the number of unemployed actively searching for a job, but rather the number of people driven out of the labour market for the long run.* People driven out of the labour market are the hopeless unemployed, early retirees, disability pensioners, and those who work in the black economy.

is low in the first three months of every year and then increases each quarter. It reaches its top value in the third or fourth quarter and again falls off at the beginning of the following year.

Figure 2: *Employment and non-participation, 2000–2003 (thousand persons)*

Source: HCSO (2003d).

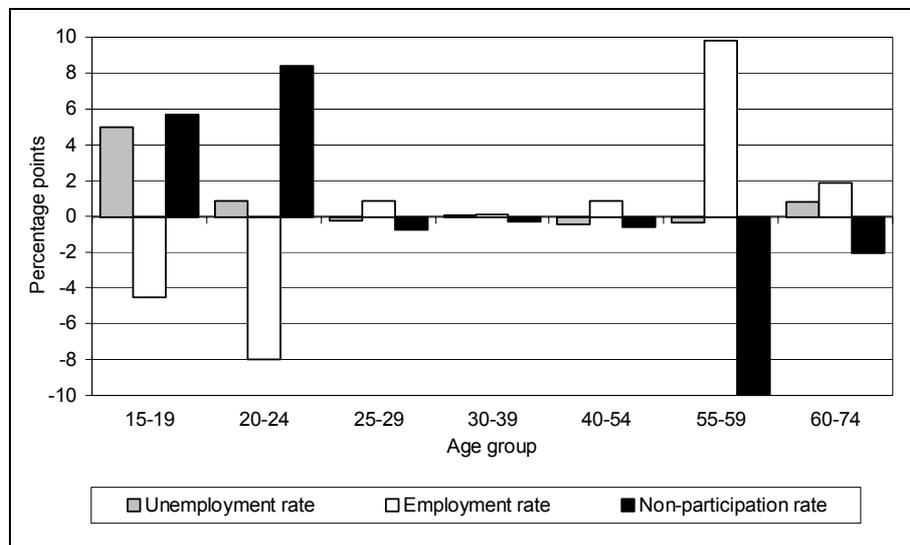
Employment, unemployment and non-participation naturally differ by skills level, and these differences have grown in recent years. The data suggest that ‘high-skilled unemployment’, a problem stressed by the Hungarian mass media, is not a significant problem, and definitely not a problem of growing importance.³ In contrast, people with a low level of education have experienced an increasing rate of unemployment; the increase being strongest among the poorest educated (those with an educational achievement lower than the eight-grade primary school). Besides a slowing economy, a rise in the minimum wage could have had an effect, although this may be less important (see our further analysis).

Youth unemployment often arises as a problem in Europe, and Hungary is no exception. From *Figure 3* it is obvious that it is the youngest and the older cohorts who have experienced the most significant changes since 2000. While employment among 15–24 year olds has decreased and their unemployment and non-participation has risen, just the opposite is true for 55–74 year olds. Most striking is the increasing employment and falling non-participation among 55–59 year olds. This is probably a result of the decline of early retirement and the raising of the official retirement age. No such phenomenon is observed for the other age groups, which means that *increas-*

³ The unemployment rate has been around one per cent for (5 year) university graduates and two per cent for (3–4 year) college graduates. There is no evidence of any upward trend.

ing employment and decreasing non-participation in Hungary is entirely due to trends among those aged 55 and over. The adverse tendency among the young draws attention to the growing difficulty of finding a job at the start of one's career, but also, and perhaps more importantly, to labour market disadvantages among the unskilled—since the recession affects particularly those aged between 15 and 19 who are not only young but also poorly educated. Our data show no evidence for worsening labour market prospects among well-qualified young people.

Figure 3: Changes in employment, unemployment and non-participation by age group, 2000–2003 (percentage points)



Source: HCSO (2000d, 2001d, 2002d, 2003d), HCSO–Stadat (2004).

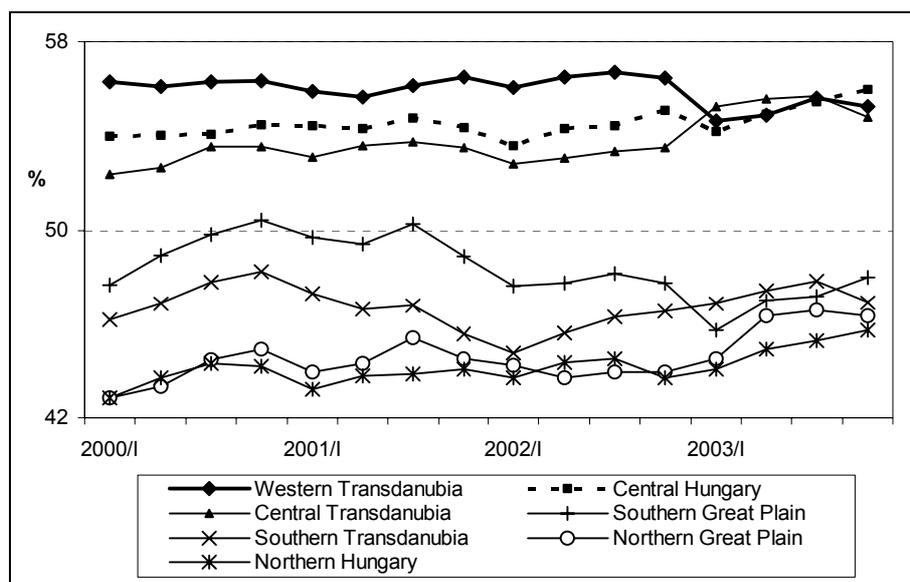
Regional and sectoral trends in employment⁴

In terms of employment rates, the regional divide in Hungary had deepened by 2003, as is documented by Figure 4. In Central Hungary, Western and Central Transdanubia, the employment rate exceeds 55 per cent (which is still somewhat below the EU average). By contrast, Southern Transdanubia and the regions east of the River Danube are experiencing an employment rate of 46–47 per cent. Four years ago the two groups of regions were not as sharply divided. In 2000, there were significant differences *within* each group, but with convergence those had all but disappeared by 2003: the

⁴ The sources of data are HCSO (2000a,b,c,d; 2001a,b,c,d; 2002a,b,c,d; 2003a,b,c,d).

situation in regions with higher employment rates within the group had worsened, while in regions with lower employment rates within the group it had improved. *Between* the two groups of regions, however, no signs of convergence can be detected: at the end of 2003 the average difference was still nine percentage points, just as at the start of 2000.

Figure 4: *Employment rates in the seven regions of Hungary, 2000–2003 (%)*



Source: HCSO (2000d, 2001d, 2002d, 2003d).

Regional trends in non-participation show a mirror image. Unemployment rates, however, do show small deviations.⁵

Agricultural employment has decreased continuously: by 2003, only five per cent of the population made their living from agriculture. In tandem with this, between 2000 and 2002, first the employment share of manufacturing increased, to be followed by a similar increase in the service sector in 2003. The exact data are included in *Table 1*.

⁵ The national rate of unemployment has fallen in the past four years. The three more developed regions have been characterized by a slight drop and convergence; by the end of 2003 they had a rate of 4.5 per cent. The situation in the less developed regions is more complex: unemployment has fallen slightly in Southern Transdanubia and significantly in the Northern Great Plain, while it has increased steadily from its initial low value in the Southern Great Plain. By 2003, the unemployment rate had reached 6.5–8 per cent in these three regions. Northern Hungary tells a unique story: after 2000, the unemployment rate—initially beyond 10 per cent—fell, as in the Northern Great Plain, but at the end of 2002, unlike in the Northern Great Plain, it jumped above 10 per cent again and stayed above 9 per cent in 2003.

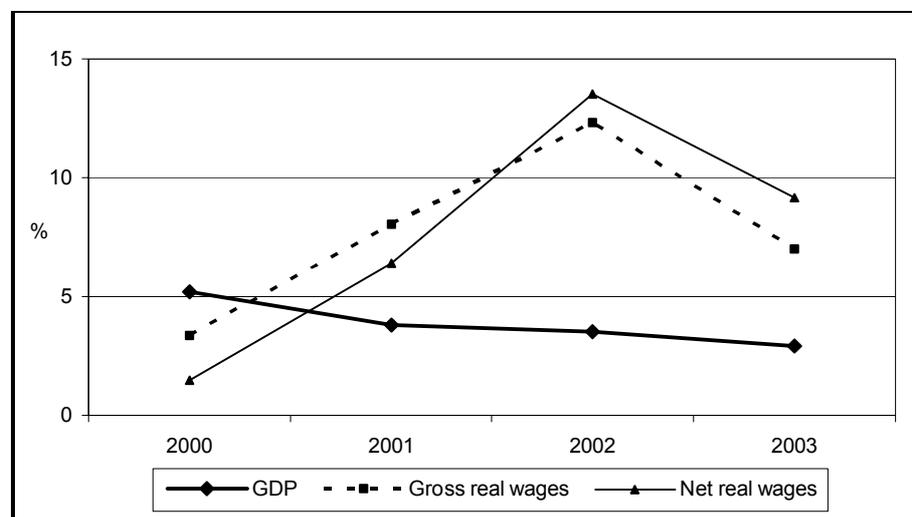
Table 1: Sectoral distribution of employment, 2000–2003

	2000	2001	2002	2003
Agriculture	6.5	6.2	6.2	5.5
Industry	33.7	34.2	34.1	33.3
Services	59.7	59.6	59.7	61.2
<i>Total</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>	<i>100.0</i>

Source: HCSO (2000a,b,c,d; 2001a,b,c,d; 2002a,b,c,d; 2003a,b,c,d).

Earnings

Between 2000 and 2003, earnings (both gross and net) grew by an annual average of 15 per cent in nominal and eight per cent in real terms. *Figure 5* shows the annual growth rate of earnings and GDP. While in 2000 GDP growth exceeded earnings growth, since 2001 the opposite has been true. In particular, 2002 stands out: a 12 per cent growth in gross real earnings (more than 13 per cent in net earnings) in contrast to a 3.5 per cent increase in GDP. By 2003, the growth in earnings had fallen back slightly but still exceeded GDP growth.

Figure 5: Growth rate of GDP and real wages, 2000–2003 (%)

Source: Nominal wages: HCSO, 2000–2003; inflation and GDP: HCSO–Stadat (2004).

Table 2: Average growth in gross wages, 2000–2003 (%)

	Private sector	Public sector Nominal	Overall	Private sector	Public sector Real	Sum
Blue-collar	13	19	14	5	11	6
White-collar	13	20	16	5	12	8
Overall	13	20	15	6	12	8

Note: Public sector is mainly public administration, health, and education. Private sector is almost everything else.

Source: Nominal wages: HCSO (2000e, 2001e, 2002e, 2003e); inflation: HCSO–Stadat (2004).

Table 2 shows the annual rate of growth of gross earnings by sector. In the public sector the ratio of blue-collar workers is about 30 per cent, as against more than 60 per cent in the private sector. As a consequence, sectoral earnings cannot be compared directly. The growth rate, however, is comparable (since neither the level nor the structure of employment has changed significantly). On average, earnings in the public sector have increased annually 7 per cent faster than in the private sector—in real terms, that amounts to more than double the growth rate. The extent and the impact of increased public sector wages will be discussed in detail in the next section.

Wages in the public and the private sectors⁶

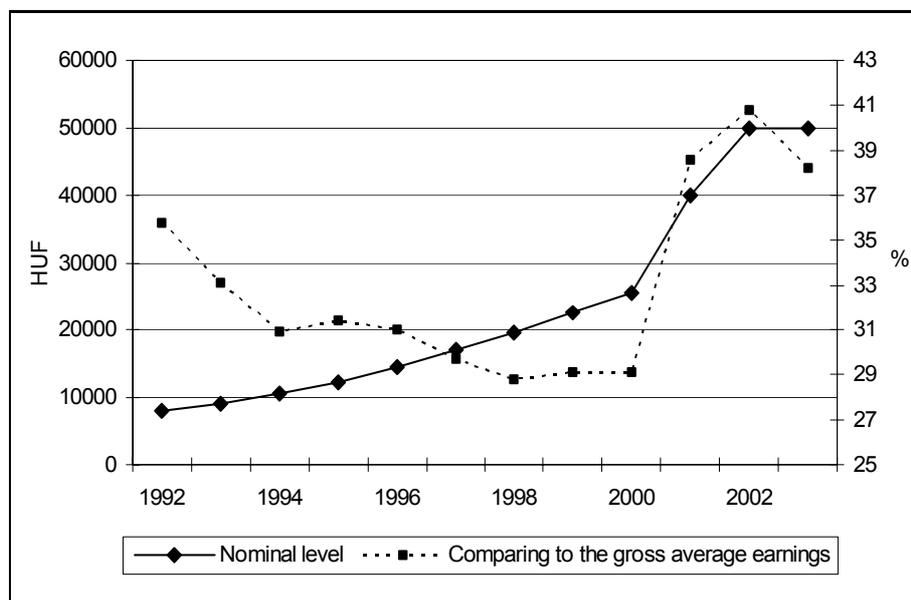
In 2001 there was a significant increase in public sector wages among both blue- and white-collar workers. The gross wage increase was 22 per cent on current prices, which meant a 12 per cent real wage growth (indexed by consumer price inflation). The impact of the public sector wage rise in 2002 extended into 2003 as well, and by the end of the year it had resulted in a 23 per cent increase in gross nominal wages. In 2001–2002, public administration employees received a higher wage rise, while from 2002 it was the turn of education and health employees.

During this period earnings in the private sector increased by significantly less (see *Table 2*), which narrowed the white-collar wage gap between the public and the private sectors; at the same time, from 2002 blue-collar workers started to earn more in the public sector than in the private sector. The timing of white- versus blue-collar wage increases, and more detailed aggregate time series suggest that the public sector wage rises did have an effect on private sector wages.

⁶ Source: Nominal wages: HCSO (2000e, 2001e, 2002e, 2003e); inflation: HCSO–Stadat (2004).

Instead of decreasing, public sector employment increased slightly after the wage rises. Having stagnated between 2000 and 2001, public sector employment grew to 820 thousand by 2003, which meant a four per cent increase on the 790 thousand in 2001.⁷ All branches took a share of the increased employment, but foremost did public administration and health. As a consequence, the wage burden on the public sector increased by more than was warranted by the wage rises.

Figure 6: *Minimum wage in Hungary, 1992–2003 (HUF, %)*



Source: Fazekas (ed. 2003: 248).

The effects of minimum wage rises

The minimum wage was significantly raised twice between 2000 and 2003: first on 1st January 2001 from 25,500 forints to 40,000 forints (57 per cent), then on 1st January 2002 to 50,000 forints (another 25 per cent). *Figure 6* shows the time series of the minimum wage from 1992. The figure shows that both rises were high in nominal terms and especially large in real terms (compared to average gross earnings). The minimum wage had dropped from 36 per cent to 29 per cent of earnings between 1992 and 2000. As a consequence of the two rises, it increased to more than 40 per cent, its high-

⁷ Source: HCSO (2000a,b,c,d; 2001a,b,c,d; 2002a,b,c,d; 2003a,b,c,d).

est level since 1989, but not especially high relative to the early 1990s. The newly increased minimum wage brings Hungary into the middle of the European field in terms of its ratio to average earnings (Fazekas ed. 2003: 327).

The minimum wage reforms raised several expectations and fears. When all is said and done, though, it seems that apart from the direct impact (i.e. improvement in the position of those with the lowest earnings) not many of these have been realized, in the short run at least.⁸ The strongest fear was that there would be a significant negative effect on labour demand: because of the rising costs of employment, enterprises could go bankrupt or dismiss employees. The minimum wage rises coincided with an economic slowdown. Employment, however, seems not to have dropped any more than would have been expected at that time of year either in January 2001 or 2002 (see *Figure 1*). Long-term effects are conceivable, but the sectoral labour turnover figures do not suggest significant dismissals: in some low-skilled industries employment has decreased or its growth has slowed down (e.g. retail, catering), while in others it has risen even faster than before (e.g. construction) (Popper 2002a,b). Although minimum wage rises disproportionately affected small and medium-sized enterprises, their number has not fallen since 2001 (HCSO–Stadat 2004). At the same time, however, minimum wage rises have had some negative effect on labour demand. As a consequence, according to the estimates of Kertesi and Köllő (2003), the national level of employment fell by 10–15 thousand in the short term. This effect cannot be ignored, although it is not extremely large: the number of people in work increased by about 50 thousand between 2002 and 2003.

Arguments were advanced both to support and to attack the measures as they affected the black economy and tax evasion. An important rationale for the reform was to force enterprises to book the entire value of labour as wages, so as to make tax evasion less prevalent. The counter-argument was just the opposite: the number of workers nominally working below the minimum wage could rise as a result of the increase in part-time employment, tax evasion and/or employment as subcontractors. Data support the positive effect: since the reform, lower wages have almost uniformly risen to the level of the new minimum wage. Employment at the minimum wage rose from four per cent in 2000 to more than 17 per cent in 2002.

As a consequence, the minimum wage rises had strong, direct effects on the wage structure. Inequalities have significantly diminished at the bottom of the wage distribution: the ratio of the first decile to the median has increased from 46 to 53 per cent.

The data available do not allow the long-term and indirect effects to be estimated. The most important reason for this is that, right after the minimum

⁸ The following section is based on the results of Kertesi and Köllő (2003).

wage rises, economic growth slowed down due to exogenous factors, and also the public sector wage rises introduced an additional factor into the Hungarian labour market. As a consequence, the separation of effects became impossible. It is plausible, however, that the minimum wage rises did play an important role in the increasing real wages of even high earners (in order not to alter differentials), and in the accelerating inflation. In addition, it is also conceivable that in the long run, the prospects for economic growth also deteriorated because of the reduced competitiveness of small and medium-sized enterprises.

Earnings and education

The significant expansion of Hungarian higher education made many worry that the prospects of highly skilled workers would become worse, more and more professions would become saturated, wages would be forced down, and as a result, returns to higher education would disappear. The data, however, do not so far support the theory of decreasing returns. Instead, since the middle of the 1990s, the number of jobs requiring higher education has grown rapidly; the growth in the supply of workers with a higher education can just keep up with increased demand, and as a result, returns to higher education have stayed high compared to the rest of the world.

According to studies of the Hungarian labour market transition (Galasi 2004a,b; Kertesi and Köllő 1995, 1997, 1999, 2002; Kézdi 2002; Kőrösi 1998, 2000, 2002) the trends of the last decade can be summed up as follows. The transformation shock lasted until 1995–1996, during which time significant job destruction did not coincide with job creation, but rather with considerable sectoral reallocation. Many older and less well-educated employees were driven out of the labour market, and the demand for skills did not increase significantly. In the second period (up to the end of the 1990s) the structure of jobs changed considerably within sectors. The number of jobs requiring up-to-date knowledge and qualified employees grew significantly. The earnings of the young and qualified kept on rising and the devaluation of the labour market experience of older people continued as well. The background to this was an effective rise in the demand for a better skilled and flexible labour force, fuelled by capital-rich foreign companies.

Transition brought about a significant expansion of higher education. The growth of the wage premium for a young, qualified workforce coincided with this expansion, and, in spite of the considerably increased supply of qualified young employees, it is not yet adequate. Since 2000, these trends have continued with rather less intensity, which means that supply is effectively catching up with demand.

Table 3 shows the wage premium for different levels of education relative to primary school or less.⁹ The results support the claims made above, as they do not indicate a decreasing return to education either for all employees or the young. If there is a noticeable change in the trends, then it is among vocational training school graduates: their wage premium has decreased slightly relative to its high value of 1999.

Table 3: Returns to education relative to (at most) primary school, 1989–2002 (%)

All employees	1989	1992	1995	1999	2002
Vocational training school	12	14	11	13	9
Secondary school (with General Maturity Certificate)	26	36	34	43	38
Higher education	58	66	69	86	87
Employees aged 22–30					
Vocational training school	8	7	7	12	7
Secondary school (with General Maturity Certificate)	14	22	24	36	31
Higher education	39	45	53	82	85

Note: The table shows estimates from earning regressions. The dependent variable is the natural logarithm of earnings (log earnings), the independent variables, besides education level categories, are sex, labour market experience, and the square of the labour market experience. The number of observations in the whole sample is 130–190 thousand, and 20–40 thousand persons in the sample of the young. The R^2 are about 30–40 per cent (20 per cent among the young). Standard error estimates are robust to heteroscedasticity and within-firm correlations (clustering). We do not report standard errors; they are all below one per cent.

Source: own calculations.

These arguments are supported by more sophisticated analysis. Péter Galasi (2004a) shows that the number of jobs that favour higher education continued to rise between 2000 and 2002. At the same time, because of the expansion of higher education, the supply of a highly qualified labour force became more flexible, and so the ratio of qualified people rose in these jobs. The wage premium growth of highly educated people slowed down or stopped as well, but the return is still high by international comparison. As a result, the opportunities for highly qualified people to find a job have not fallen, and nor has their wage premium decreased significantly toward the lower international level.

The more general problem of over- and undereducation—which was also analysed by Péter Galasi in another study (Galasi 2004b)¹⁰—is similar to that

⁹ Calculations are based on simple earning regressions, using data from the wage survey of the National Labour Centre. See Kertesi and Köllő (1997) for more details.

¹⁰ In connection with this see Péter Galasi's paper in the present volume, titled *Overeducation, Undereducation and Demand*.

of highly qualified personnel. According to his analysis, since the beginning of the 1990s, the proportion of under-educated employees has decreased steadily in Hungary, while that of overeducated employees has increased continuously. At the same time, however, the return to extra education has not diminished.

From all this we can conclude that in Hungary today, the rising level of education does not have clear negative effects, either in terms of employment opportunities, or in terms of the wage premium.

Summary

Our most important statements could be summed up as follows. From the labour market point of view, the most important social problem Hungary faces is low employment. Although unemployment (the ratio of active job-seekers) is low by comparison with other countries, this conceals the more severe problems of non-participation and hopeless unemployment (those who do not bother to search for a job for geographical or qualification reasons). The problem of youth unemployment is also, in large part, a problem of the young uneducated, and this is storing up severe long-term problems.

The divide between Hungary's more developed and less developed parts has deepened. By 2003, Budapest, the Western and Central Transdanubia regions had sharply separated from the other parts of the country. Between the 'two Hungaries' the differences that already existed in labour market prospects have become entrenched and have deepened.

Between 2000 and 2003, employment increased slightly, primarily due to the rise in the retirement age, but this increase was well behind GDP growth. In contrast, in 2001 and particularly in 2002–2003, earnings increased at a rate well in excess of GDP. The significant (about 50 per cent over three years) wage increase in the public sector played an important role. This wage increase was accompanied by a rising employment (about four per cent) in the public sector, which made the burden on the budget ever more serious. As a more direct result, the private–public sector wage gap narrowed for white-collar workers and completely disappeared for blue-collar workers. At the same time, it seems that the public sector wage rises spilled over into the private sector. The measures, therefore, may be responsible for declining competitiveness and accelerating inflation, both directly and indirectly.

The minimum wage was increased twice, to an all-time high relative to average wages, though the difference between the situation now and at the beginning of the 1990s is not exceptionally large. The Hungarian minimum wage, by comparison with Europe generally, is still about average, at least relative to the average wage. The minimum wage reforms decreased earnings inequality but entailed a slight fall in employment. This effect has not been

large in the short term, though we cannot rule out the possibility that it did contribute to the reduction in employment growth. No adverse impact on the black economy and tax evasion can be demonstrated. Some indirect and long-term negative effects are conceivable, however, on the competitiveness of small and medium-sized enterprises on the one hand, and on accelerating inflation on the other hand.

The level of education has improved steadily, and as a consequence—depending on the definition—the phenomenon of over-qualification has also appeared in certain areas. The data, however, do not imply falling returns to education, not even among the youngest cohorts. Though at first glance it may not seem necessary, employers are willing to pay above the going rate for better skills. There is no evidence of unnecessary overeducation at college level: for graduates the possibility of unemployment has not increased, their earnings compared to those of others have continued to rise, as has their employment level. Instead, the real social problem is the still worsening labour market chances of those with a poor education and of people living in the underprivileged regions of the country.

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Tamás Kolosi, György Vukovich, István György Tóth eds.

Table of Contents

Introduction

Tamás Kolosi, István György Tóth and György Vukovich

PART I: SOCIAL INDICATORS, SOCIAL STRUCTURE

- 1 Hungarian Society Reflected in Indicators
(Erzsébet Bukodi, István Harcsa and György Vukovich)
- 2 Key Processes of Structural Transformation and Mobility
in Hungarian Society since the Fall of Communism
(Tamás Kolosi and Péter Róbert)
- 3 Income Composition and Inequalities, 1987–2003
(István György Tóth)
- 4 Poverty in Hungary on the Eve of Entry to the EU
(András Gábos and Péter Szivós)

PART II: DEMOGRAPHIC PROCESSES AND WELFARE SYSTEM

- 5 Hungarian Population Characteristics in the EU Context
(Gabriella Vukovich)
- 6 Fertility Decline, Changes in Partnership Formation and Their Linkages
(Zolt Spéder)
- 7 Lifestyle and Well-being in the Elderly Population
(Edit S. Molnár)
- 8 Effects of Intergenerational Public Transfers on Fertility: Test on Hungarian Data
(Róbert Iván Gál and András Gábos)
- 9 Housing Conditions and State Assistance, 1999–2003
(János Farkas, József Hegedüs and Gáborné Székely)
- 10 Educational Performance and Social Background in International Comparison
(Péter Róbert)

PART III: LABOUR MARKET AND HOUSEHOLD ECONOMICS

- 11 **Labour Market Trends, 2000–2003**
(Gábor Kézdi, Hedvig Horváth, and Péter Hudomiet)
- 12 Business Expectations of the Largest Exporters at the Beginning of 2004
(István János Tóth)
- 13 Low Participation among Older Men and the Disincentive Effects
of Social Transfers: The Case of Hungary
(Orsolya Lelkes and Ágota Scharle)
- 14 Overeducation, Undereducation and Demand
(Péter Galasi)
- 15 The Labour Market and Migration: Threat or Opportunity?
(Ágnes Hárs, Bori Simonovits and Endre Sik)
- 16 General Characteristics of Household Consumption with Focus
on Two Fields of Expenditure
(Anikó Bernát and Péter Szivós)

PART IV: INFORMATION SOCIETY

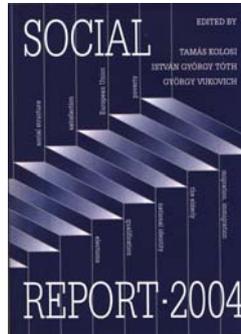
- 17 Digital Inequality and Types of Info-communication Tool Use
(Róbert Angelusz, Zoltán Fábán and Róbert Tardos)
- 18 The Spread of Information Technology: Objective and Subjective Obstacles
(Tibor Dessewffy and Zsófia Rét)
- 19 The Development of Electronic Commerce in Hungary
and in Countries of the European Union
(László Szabó)
- 20 E-government in Hungary Today
(Teréz N. Vajdai)

PART V: MINORITY AND MAJORITY IN HUNGARY

- 21 Is Prejudice Growing in Hungary
(Zolt Enyedi, Zoltán Fábán and Endre Sik)
- 22 The Income Situation of Gypsy Families
(Béla Janky)
- 23 Residential Segregation and Social Tensions in Hungarian Settlements
(Marianna Kopasz)
- 24 The Social Position of Immigrants
(Iren Gödri and Pál Péter Tóth)

PART VI: POLITICAL BEHAVIOUR, SOCIAL ATTITUDES

- 25 Trends in Party Choice after the Change in Government
(István Stumpf)
- 26 Public Support for EU Accession in Hungary
(Gergely Karácsony)
- 27 National Identity in Hungary at the Turn of the Millennium
(György Csepeli, Antal Örkény, Mária Székelyi and János Poór)
- 28 The Individual and Social Components of Insecurity
(György Lengyel and Lilla Vicsek)



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Useful Addresses:

President: Tamás Kolosi, kolosi@tarki.hu
General Director: István György Tóth, toth@tarki.hu
Scientific Director: Tamás Rudas, rudas@tarki.hu
Survey Dept: Matild Sági, sagi@tarki.hu
Data Archive Dept: Zoltán Fábrián, fabian@tarki.hu
Office Manager: Katalin Werner, wernerka@tarki.hu