Labour-market frictions in DSGE models

Zoltán M. Jakab and István Kónya

The purpose of this paper is to describe the basic model of labour-market search and its usage in a New Keynesian (DSGE) setting. A general description is followed by an account of how this approach can be used to understand Hungary's macroeconomic developments better. For this purpose the authors describe a version of the model developed for the Hungarian economy and estimated on Hungarian data, using Bayesian techniques. The estimated model is compared to another estimated New Keynesian models that differ only in their description of the labour market. Based on the results, search frictions lead to more realistic impulse responses and estimated historical shocks. An important element in this approach is to incorporate wage rigidities separately for existing jobs and for new hires. The estimated wage rigidity in existing jobs is high, and comparable to previous estimates for Hungary. Wages for new hires, on the other hand, react far more to shocks that hit the economy.

Annual rates of return in the Hungarian pension system

Róbert Iván Gál and András Simonovits

Applying a theorem established by Willis (1988), proved by Lee (1994) and generalized by Bommier and Lee (2003), allows longitudinal conclusions to be derived from cross-sectional data. Using this method, the authors calculate period implicit rates of return in the Hungarian national pay-as-you-go (PAYG) pension scheme from current contributions, and the difference between the weighted average age of pensioners and of contributors for the years 1992–2008. It is shown that the PAYG pillar produced negative returns through the first half of the 1990s, since the employment crisis undermined the contribution base. In the absence of an automatic balance mechanism to stabilize the system continuously by step-by-step devaluation of current and future pensions, there occurred in 1997 a radical devaluation in the form of a comprehensive pension reform. However, the system became unsustainable again with increasing speed after 2002 and required another round of radical stabilization, which came with the new parametric reform of 2009.

The anti-empirical axiomatism of the neo-Walrasian general equilibrium theory

Tamás Dusek

Advocates of neoclassical economics treat the axiomatic form of the neo-Walrasian general equilibrium theory as a glorious masterpiece of economic theory. The main aim of this paper is to examine the methodological background to the theory, particularly the arguments for giving preferring the axiomatic method. After presenting successful examples of the axiomatic method, the author demonstrates that the alleged parallel between the axiomatized part of physics and the neoclassical type of axiomatic form of one part of economics is based on various misunderstandings and not valid at all, because the latter has no empirical content. The second part of the paper outlines briefly the interpretation put on the neo-Walrasian system by contemporary methodologists and writers on the history of economic thought, and also touches on its presentation in textbooks. The significance of the topic is supported by the enduring popularity of the theory and by the general features of the methodological problems discussed.

Purchase of work or renting of workers? Speculating on the economic interpretation of the employment relationship

István R. Gábor

Should the employment relationship be interpreted as a form of purchase of labour services or as one of renting workers? Economics typically portrays it as the latter, but idealizes it as the former. This apparent inconsistency can presumably be attributed to the dilemma arising from the theoretical incompatibility of the core economic concept of competitive equilibrium and the reality of mass renting of people in the labour market.

Analysing macroeconomic risks in the state budget

Gusztáv Báger, Péter Galbács and Gyula Pulay

The paper presents the methodological framework for an analysing system new in the practice of Hungary's State Audit Office. This gave policy-makers help in assessing the bill proposing the state budget for 2012. In addition the authors review briefly some important statements derived from risk analysis. The usefulness of the method is indicated by its ability to highlight the serious risk that GDP growth would lag behind both growth potential and the 1.5% target forecast by the government. Correlating with this, employment in the private sector will not increase either. The risk of this diminished economic growth is explained not by a drop in export dynamics, but by an insufficient rise in investment coupled with a further setback in household consumption. The authors suggest a programme of government action costing HUF 100–150 billion as a way to improve the balance and build greater reserves into the state budget.