Meritocratic economic policies in the service of the middle class

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SUMMARY: By the 2010s, the middle classes of the Western world had become the biggest losers from the accelerating globalisation processes since the 1970s. Several proposals have been made regarding what economic policies should be put in place to strengthen the lower classes. These would typically redistribute income from the rich to the poor. Hungary has chosen a particular path in response to the disadvantages of globalisation: in our interpretation, it has shifted income from the rent-seekers to the middle class. Based on our definition of the middle class, which takes into account income, wealth, housing and the need for intellectual and cultural development, the middle class in Hungary expanded from 34.9 to 54.6 percent of society between 2011 and 2021 – in ten years, it expanded one and a half times. In our research, we investigated which measures have contributed to this and whether this could be the basis of a meritocratic economic policy mix that could be used in other countries.
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Problem statement, context: globalisation and its disadvantages

The relationship between income distribution, income inequality and globalisation has long been a topic of interest for researchers. A study by Stiglitz, Sen and Fitoussi (2009) highlights that average values do not tell the whole story, hence the need for a greater focus on the distribution of income, consumption and wealth, i.e. on aspects

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This study was prepared using the EU-SILC and HBS datasets of the Hungarian Central Statistical Office. The calculations and the conclusions drawn from them are the sole intellectual property of Dr. László György, Gergely Horváth and Dániel Molnár as authors.

of social sustainability. One tool for this has been the Lakner-Milanovic graph[2] , first published in 2013, which shows how income varies globally across income groups. The results[3] show that the income of the top 1 percent has risen substantially faster than that of the middle 40 percent over the long term, while the real income of the lower middle class in the West and the middle classes in Central and Eastern Europe even declined between 1988 and 2008. Piketty, Saez and Zucman (2016), Stiglitz (2017) and György (2017) find similar results on the effects of the accelerating globalisation in the 1970s on the incomes of below-average earners in the US between 1980 and 2010.

Dalio (2021) has shown, through historical examples, that the internal symptoms of the decline of a hegemon include an increase in income inequality[4], polarisation, stagnation or even a decline in the growth of living standards for broad social strata. Thus, the changes of the past decades are a recurring phenomenon in a broader context, and hence the examination of the situation of the middle class is crucial for the future. With this in mind, our study seeks to answer the question of the extent to which economic policy in Hungary over the past ten years has helped the middle class to expand and advance, and what impact it has had on its position. Our hypothesis in this respect is short and to the point: the situation of the middle class in 2021 is significantly better than in the early 2000s and 2010s.

The middle class is the basis of economic prosperity

The importance of the middle class has been stressed by many social scientists, philosophers, and economists. Pressman (2007), often quoted on the subject, points out that a broad and prosperous middle class is a major contributor to economic growth and good macroeconomic performance. Indeed, rising income inequality can reduce consumption, thereby reducing demand and slowing economic growth. This could ultimately lead to fewer jobs, lower income levels and a shrinking middle class (Brown, 2004; Pressman, 1997). In this context, the IMF (Dabla Norris et al., 2015) and the OECD (2015) warn of a decline in growth potential due to rising income inequality.

Moreover, the existence of a strong middle class supports social and political stability by acting as a buffer between the rich and the poor (Pressman, 2007). Aristotle (1999) already noted that communities with a broad middle class are better organised and thus can help to create more stable democracies. Barro (1999) has confirmed this empirically: his research shows that the higher the share of income that goes to the middle class, the more likely a country is to have a democratic system. In addition, societies with a broader middle class have higher levels of trust

2 More commonly known as the Elephant Curve. For details see Lakner and Milanovic (2015)
3 See e.g. Alvaredo et al. (2018)
4 The negative effects of this are also discussed in Botos (2020), using the example of the United States.

in democratic institutions and lower levels of crime. And higher levels of trust in general have other positive returns such as lower social transaction costs and the promotion of innovation (Gould and Hijzen, 2016; Madland, 2015).

A strong middle class is vital for all economies and societies, as it has a high level of consumption – and thus demand –, and invests the most in education, health and housing (OECD, 2019). Middle-class members increase the amount of current and future human capital through their own and their children's spending on education, thus supporting GDP growth (Brueckner et al, 2017). The middle class is also strongly involved in capital accumulation as a source of innovation and entrepreneurship. According to the OECD (2010), the existence of a strong middle class is an important factor in the prosperity of the entrepreneurial sector and the development of small and medium-sized enterprises (SMEs).

According to Malthus (1826), the importance of the middle class is further shown by the fact that its increase in proportion contributes to the rise in overall social happiness. This also stems from the fact that middle-class status is seen as a desirable status to be achieved in society at the individual level. This is supported by the phenomenon of 'middle-class bias': subjectively, more people in each country tend to consider themselves as a member of the middle class than can be considered objectively based on their income status (Evans and Kelley, 2004).

Definition of the middle class

So, there have been many statements about the importance of the middle class, its distinguished role in society and the economy, but these have not yet shed light on what exactly the middle class is, who are its members? This is by no means a simple question, and its complexity is best expressed by the often-quoted statement of Pressman (2007), who argues that any definition we come up with will be somewhat arbitrary. And indeed, as many studies, as many authors, essentially as many definitions have been put on paper.

Although the middle class as a concept is far from being an exact one, in the literature we can distinguish some approaches to define this social stratum. The subject is popular among sociologists and economists alike, but their approaches differ. Sociologists mainly carry out stratification studies[5], taking a social, cultural, and economic capital approach (Savage et al, 2013), but they also prefer more subjective indicators (e.g. self-classification), and analyses based on employment status (Goldthorpe, 2016). In contrast, economists consider income as a key indicator in their analyses, using absolute or relative thresholds to define the conditions for middle-class membership (Vaughan-Whitehead, 2016).

In our study, we take an essentially economic and not sociological approach, but not exclusively. In defining the middle class, we consider exact measurement

5 See for example Ferge (1969), Kolosi (1987)

important, but we also consider it desirable to include in our definition of the middle class not only the income and wealth situation but also the housing aspect and the need for intellectual and spiritual development. We are not alone in our aspirations. According to Beckett (2010), a typical middle-class characteristic is owning a home or a good-quality rental property, possibly owning a small business. And the OECD (2019) notes that for the middle class, housing is more than just an ordinary good: in many countries, owning a home has traditionally been a middle-class privilege. Tóth (2016a) argues that belonging to the middle-income stratum does not in itself coincide with the middle class, as it has other characteristics of wealth and savings. Among these, the author lists factors related to liquidity and investing in the future. The former refers to the existence of financial reserves to cover unexpected expenses or to cover living costs in the event of a temporary loss of income, while the latter refers to the ability to finance children's education and to save for retirement. In addition to these, Tóth (2016a) highlights the importance of having certain high-value assets, such as a home and a vehicle. Our definition of the middle class has been constructed taking all these insights into account.

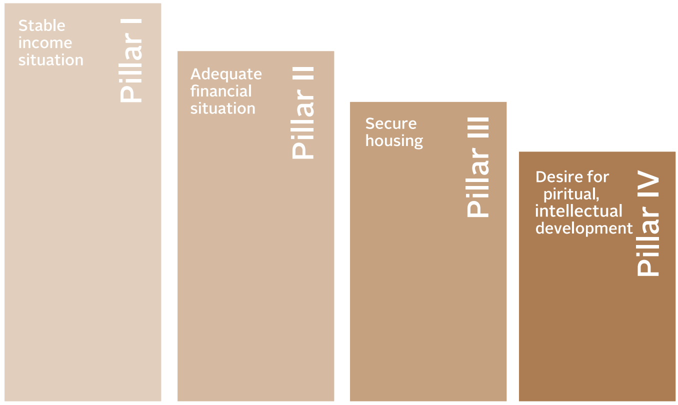
Research methodology

We have added our own intuitions to the literature and best practices to create an extended/advanced definition of the middle class. According to this definition, the middle class is defined as those households that:

> *"receive an income that guarantees a stable livelihood, are not affected by deprivation, have a secure housing and a desire for intellectual and spiritual development."*

This definition is based on four pillars (Figure 1). The three main pillars are income, wealth and housing, complemented by the desire for spiritual and intellectual development, which is captured by questions on the consumption of cultural goods. The latter requires special treatment due to the limited data available, so the results obtained are also presented in the analysis by omitting this pillar.

Figure 1: The pillars of the middle-class definition



Source: own editing

The analysis of each pillar is based on data from the European Union Statistics on Income and Living Conditions (EU-SILC) for 2004–2005 and 2011–2021. For the income dimension, we use the International Labour Organisation (ILO) definition of 5 categories based on the median of equivalised household disposable income (Vaughan-Whitehead, 2016):

- up to 60 percent – lower class;
- between 60 and 80 percent – lower middle class;
- between 80 and 120 percent – core middle class;
- between 120 and 200 percent – upper middle class;
- above 200 percent – upper class.

Households with a stable living income are those with an equivalised disposable income between 60 and 200 percent of the median – so they are the middle class in income terms. The lower limit of 60 percent of median equivalised income is justified by the poverty line. Those with incomes above 200 percent of median income are considered well-off and are not part of the middle class.

The reason for using equivalised income is that it is not justified to give equal weight to each household member, as the consumption of a household does not increase in proportion to the increase in the number of members in the household, an example of this can be the cost of utilities. Several methodologies are available for calculating equivalised income, of which the OECD-modified scale (Hagenaars et al., 1994) was used for this calculation. According to this methodology, the first adult in a household is weighted at 1, all other adults have a weight of 0.5, and children have a weight of 0.3 in the calculation of disposable income.

The dimension describing the material situation was basically captured through two pillars, namely exposure to material and social deprivation and housing. The former is justified by Tóth's (2016b) finding that in the early 2010s, a significant proportion of households belonging to the middle-income class in Hungary was considered to be materially deprived[6]. However, it is a legitimate suggestion that material deprivation does not fit into the picture of middle-class households and should not be part of it. On this basis, materially and socially deprived but income-qualified households[7] are excluded from the middle class and classified as lower class.

The material dimension also includes the provision of secure housing for the middle class. In our reading, this means, on the one hand, that the household either lives in its own property without a mortgage or in a mortgaged property but has no difficulty in repaying the loan and is not in arrears. We do not include people living in rented properties who pay their rent regularly. It is because living in a rented property is less secure compared to living in an own property: the availability of the rented property and the amount of the rent is a variable factor, reflecting a degree of vulnerability to the investment decision of the property owner.

We expand the income and material dimensions through Pillar IV, where we make the desire for intellectual and spiritual development a condition for belonging to the middle class – captured by an interest in cultural programmes[8]. Thus, a household belongs to the middle class in this sense if it shows an interest in at least two of the four programmes (programme groups)[9] surveyed, i.e. if it has participated in them in the past year or would have participated if it had not been prevented from doing so for some reason (e.g. health).

However, the questions used for this pillar were only asked in the surveys for 2014 and 2021. In order to see the change in the share of the middle class over the examined time period, we have estimated the consumption of culture for 2011 based on 2014 data.

The evolution of the middle class

The Hungarian middle class can be considered to be very broad in terms of income in Pillar I and has remained close to the 80 percent of the population throughout the period under study, with no significant change overall. However, within the middle class, a kind of internal rearrangement can be seen within the individual income groups up to 2019, to the detriment of the core middle class and in favour of the upper middle class. Nevertheless, this process is assumed to have been reversed in

6 In his assessment of the situation, Tóth (2016b) still used the old indicator of material deprivation, which was still current at the time. Since 2014, the indicator has been revised and extended, but its results are comparable to the deprivation indicator calculated by the previous methodology. See Guio et al. (2012) and Guio et al. (2017).

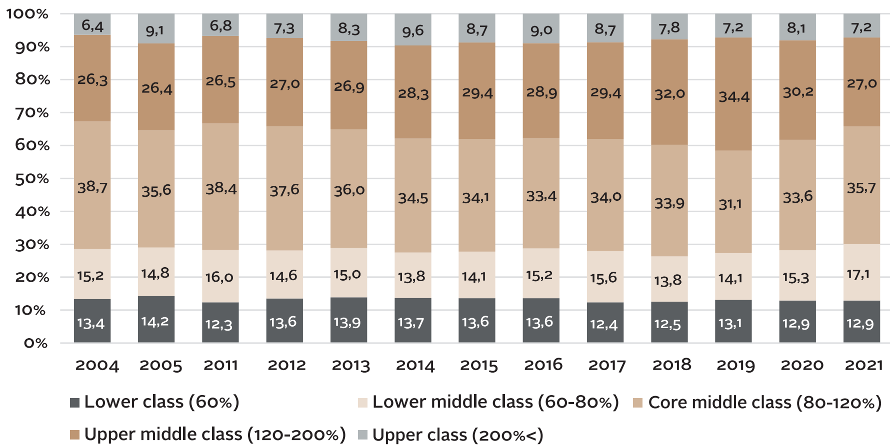
7 Households where at least half of the adult household members are considered to be materially and socially deprived.

8 Due to the scarcity of available data, we did not have much room for manoeuvre in this process, as these were the variables most related to culture in the database used.

9 Cinema; theatre plays, concerts, operas, ballet and dance performances; museums, art galleries, historical monuments, archaeological sites, other cultural sites; live sport events.

the subsequent years as a result of the COVID-19 pandemic, resulting in the narrowing of the upper middle class and an expansion of the core and, to a lesser extent, the lower middle class. Nonetheless, this only reflects the relatively even distribution of income in Hungarian society. This is supported by the fact that the Gini index of disposable income in Hungary is the eighth lowest in the EU (27.4 points) based on the latest data for 2022 and has even decreased by 1.2 points compared to 2014. However, this does not in itself provide any information on the absolute position of the middle-income stratum, or on for which this relative even distribution of income is sufficient in terms of living standards of the individual classes.

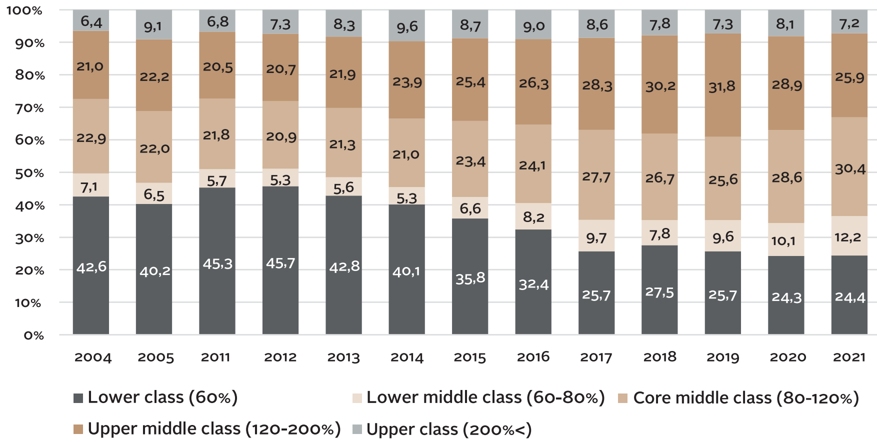
Figure 2: Trends in the middle class in terms of income



Source: EU-SILC, own calculation

In response to this, Pillar II has filtered out of the middle class those households that can be considered materially and socially deprived. As shown in Figure 3, the share of the income poor group plus the deprived will approximately triple by 2014 – the size of the lower middle class and the core middle class will also be essentially halved, and the middle class as a whole will shrink to around 50 percent. This is reflected by the fact that even the share of people living in severe material deprivation in Hungary was above 20 percent in the period 2004–2014 (excluding the years 2006–2007), according to the HCSO.

Figure 3: Trends in the middle class by income and wealth

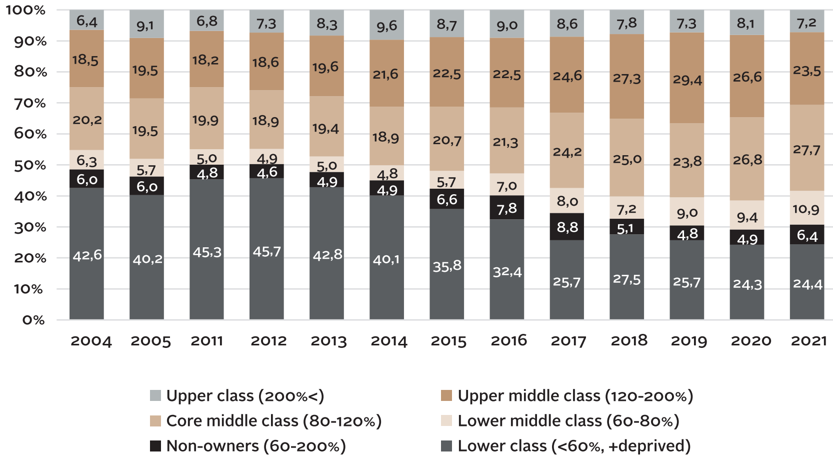


Source: EU-SILC, own calculation

The results also show a significant increase in the numbers of the lower, core and upper middle classes from 2011 onwards. In absolute terms, the core middle class grew the most, by 8.6 percentage points, while the lower middle class grew by 6.5 percentage points and the upper middle class by 5.4 percentage points. In other words, not only have those who have dropped out of the lower middle class moved into the lower middle class, but a wide range of people have managed to move up into the core and upper middle classes.

The results of Pillar III show that the share of the middle class followed the same trends presented previously: rising from a low of 42.4 percent in 2012 to stabilise above 60 percent after 2017. Between 2011 and 2017, the overall housing situation of society became less favorable, with the share of households owning their own home decreasing by 3.2 percentage points. However, there has been a significant positive turnaround in this respect, with the share of owner-occupiers increasing from 88.2 percent in 2011 to 89.2 percent in 2021. As a result, by 2021 the share of the middle class in terms of income and wealth had risen to 62.1 percent.

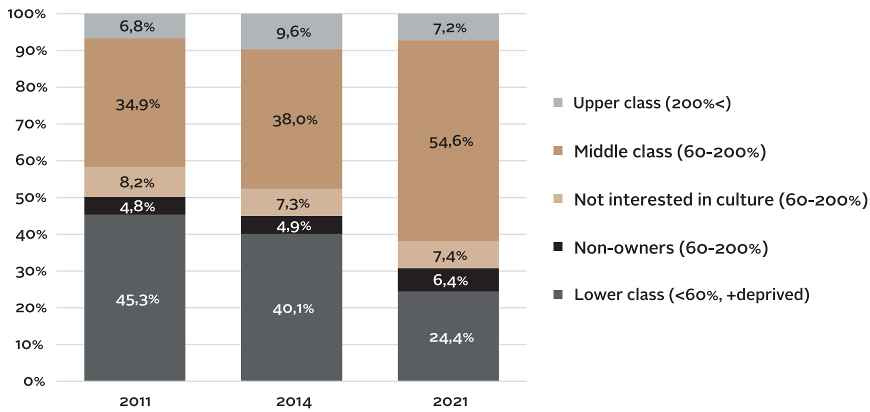
Figure 4: Trends in the middle class in terms of income, wealth and own residential property



Source: EU-SILC, own calculation

The size of the middle class also shows a significant increase according to the need for intellectual and spiritual development under Pillar IV. We have data for only two years, showing that between 2014 and 2021, the middle class grew by 16.6 percentage points. The need for intellectual and spiritual development in 2011 was estimated using the expenditure on culture, which shows that the share of expenditure on culture in the Pillar III middle class increased by around a fifth between 2011 and 2014. Using this, and the results of the 2014 survey, we have prorated the share of the households that fell out of the middle class in 2011 due to the cultural aspect. Thus, in Hungary, regarding our middle class definition, 54.6 percent of households belonged to the middle class in 2021, up from an estimated 34.9 percent in 2011. In other words, there has been an increase in interest in cultural events, i.e. an increase in the need for intellectual and spiritual development among the middle class in terms of income and material well-being.

Figure 5: Evolution of the middle class according to the desire for intellectual and spiritual development



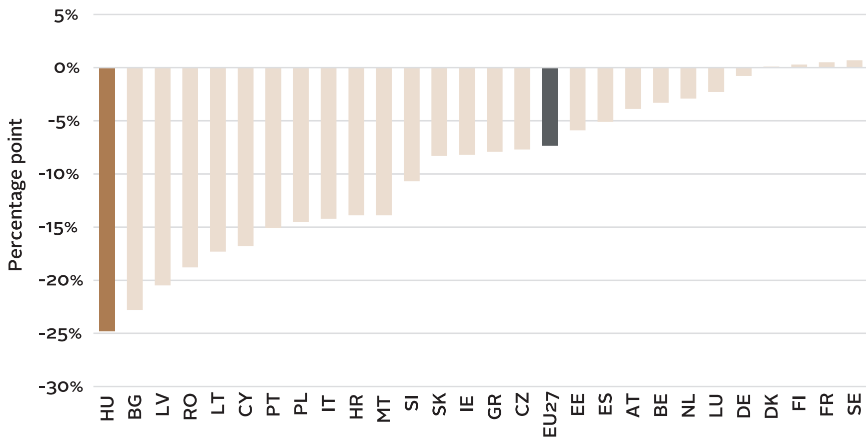
Source: EU-SILC, own calculation

The role of meritocratic economic policies in poverty eradication

The process of middle class expansion shows that although Hungarian households were in a relatively narrow range on the scale in terms of income even at the beginning of the examined time series – i.e. the level of income inequality was low –, they were still considered to be very poor in wealth terms. However, thanks to the measures described in detail in the next chapter, the deprivation index improved drastically by 2021.

So what is, on the one hand, an effort to widen the middle class is, on the other hand, an active economic and social policy to eradicate poverty. The result of these measures is that between 2014 and 2022, Hungary has seen the largest reduction in the proportion of materially and socially deprived people in the European Union. This means that households have become much better off, the share of poor people has decreased, and the middle class has increased.

Figure 6: Change in the proportion of people experiencing material and social deprivation in the EU Member States between 2014 and 2022



Source: Eurostat, own calculation

Meritocratic economic policies to support the middle class expansion

Meritocratic economic policies to support middle class expansion can be basically divided into two parts. One group includes measures that affect income redistribution, also known as direct measures. The other group consists of measures that support the expansion of the middle class by creating opportunities for the middle class or by supporting the expansion of the middle class indirectly rather than through direct public transfers. These can be referred to as structural measures.

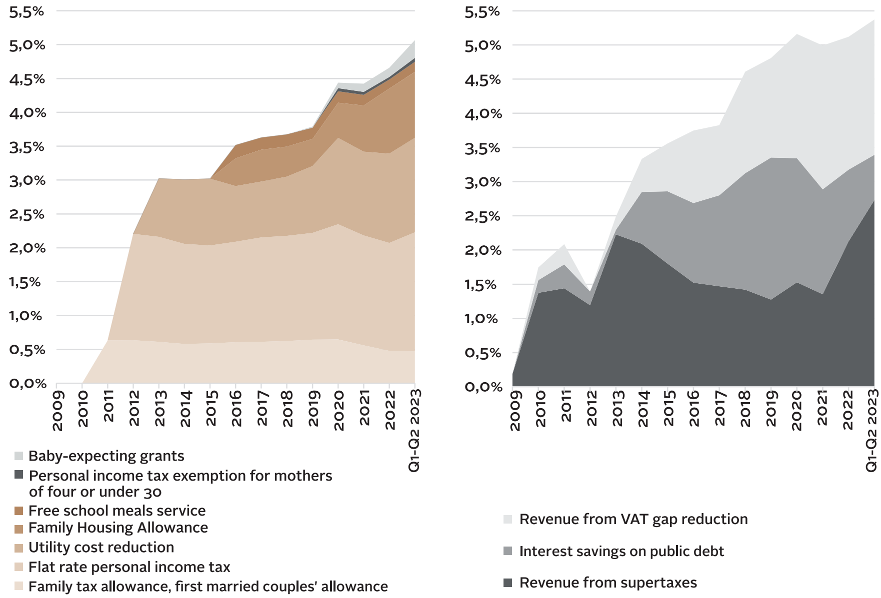
Let's look first at direct measures. The meritocratic income redistribution of Hungarian economic policy is to redistribute income from rent-seekers to working and self-employed families with children through tax cuts, family tax allowances, utility cost reductions and various family allowances. Rent-seekers are defined as economic actors (entrepreneurs or individuals) who do not profit in an innovative way in response to a market need, but exploit changes, deliberate changes or loopholes in the market structure to generate income. They can be considered as:

- financial firms that have gained extra profits by forcing market liberalisation and reducing regulators;
- utility companies that have gained extra profits due to incomplete regulation;
- the companies that skimmed state aids during the coronavirus crisis thanks to their role as intermediaries;
- energy companies that have benefited from the increased energy prices in Europe following the Russian-Ukrainian war;

- individuals on benefits who are exploiting loopholes in the social security system when they are able to work and could be working;
- entrepreneurs who conceal their income and avoid paying taxes.

The resource and expenditure side of direct measures are illustrated in Figure 7.

Figure 7: In proportion to GDP, increasing amount of income is regrouped to households



Source: based on György (2017), GDMA, Eurostat, European Commission, KFIB, HCSO, MÁK, MEKH, own calculation

In addition to the supertaxes on rent-seekers, the redistribution of income was covered by the additional revenue from the whitening of the economy, reflecting the attitude that tax capacity should be increased not by imposing new taxes but by collecting existing taxes efficiently. Also, the government has generated significant additional revenue by reducing the interest burden on public debt in the 2010s. This has been achieved by putting its finances in order, targeting and achieving a steady reduction in debt-to-GDP ratio – which can be seen as meritocratic because it seeks to create a level playing field between generations. Unlike many developed or even emerging countries (e.g. Romania), Hungary does not use debt to maintain or raise the living standards of current generations, which then becomes a burden on future generations. On the contrary, Hungary has committed itself to a long-term path towards a steadily declining debt-to-GDP ratio, in the interests of future generations, as enshrined in the Fundamental Law of Hungary.

The direct measures include the introduction of the utility cost reduction. It has made it more predictable to plan utility costs, which had been rising and were an extraordinary burden on households due to low disposable income, from 2013 onwards. We estimate that the measure has regrouped around 0.8–1.0 percent of GDP for households in the years following its introduction. The introduction of free school meals service has also had a positive impact on household finances, providing relief to families and additional disposable income of 0.15–0.2 percent of GDP per year.

To ensure a level playing field and achieve the demographic turnaround that is essential for sustainable growth, Hungarian economic policy measures have also redistributed additional income to households with children. The need for this is underlined by Bonifert's (2023) overview of the circumstances that make having children difficult. To counterbalance the financially negative effects, a new form of family support was introduced in 2011 under the name of family tax allowance. However, it is not unconditional, as eligibility is conditional on work and the level of support depends on income, unlike the previous system based on child benefit. In contrast to the latter, the family tax allowance functions as a tax base allowance, i.e. it requires taxable income. We calculate that this form of support, together with the first married couples' allowance, transfers an average of 0.6 percent of GDP to households with children, helping to finance the additional new expenditure and mitigating the temporary loss of income associated with having children. The latter is complemented by the childcare allowance, which is also income-related (with a maximum amount linked to the minimum wage).

Another important element of economic policy measures for households is the home creation scheme and its incentives linked to having children. The Family Housing Allowance (CSOK), the associated tax relief and preferential loan schemes have contributed greatly to the creation of a demand-side housing market (along with VAT relief), which has helped to create secure housing for families or those intending to start a family. Since the launch of the housing subsidy scheme in 2016, the number of housing permits issued has risen to levels not seen since 2008, to over 30,000 per year, leading to a dynamic increase in the supply of new housing in the following years. The impact of the targeted measures (and the low interest rate environment) has been reflected in the gradual increase in real estate sales transactions, which have also risen to 2008 levels, reflecting the demand for housing. All of this together has led to an increase in the share of households owning their own residential property, not only for the middle class, but for all strata. It is worth noting that family households may have been over-represented in this group, helped by the Baby-expecting loan scheme, the amount of which was typically used as own resource for the purchase of a dwelling by (prospective) families taking advantage of the scheme. We calculate that the housing subsidies have transferred around 0.4 percent of GDP to families with children at the time of introduction and around 1 percent at the end of the time series, while the Baby-expecting loan has transferred 0.1–0.2 percent.

The introduction of the flat rate personal income tax in 2012 has been a major contributor to the growth in incomes of those in work, helping to whiten higher wages alongside wage increases – putting domestic workers in a better position. We estimate that the single rate personal income tax has allowed households to realise 1.5–1.7 percent of additional income per year as a share of GDP.

Grouping meritocratic government measures in support of the middle class

Direct measures	Indirect measures
Family tax allowance, first married couples' allowance	Employment-focused reform of labour market regulation
Flat rate personal income tax	Active labour market policies (e.g. public employment)
Utility cost reduction	Soft student loans to support learning
Family Housing Allowance (CSOK)	Investment promoting and subsidised loan schemes
Free school meals service	Restructuring of taxes supporting individual businesses
Personal income tax exemption for mothers with four children or under 30	Minimum wage and guaranteed minimum wage increases
Baby-expecting grants	Conversion of foreign currency loans into HUF

Source: own collection

Figure 7 illustrates the pattern but does not show all the measures that have contributed to the middle class expansion. In addition to the measures mentioned so far, which provide immediate and direct support to households, longer-term structural reforms have been undertaken in Hungary that have laid the foundations for the expansion and strengthening of the middle class, as well as economic success.

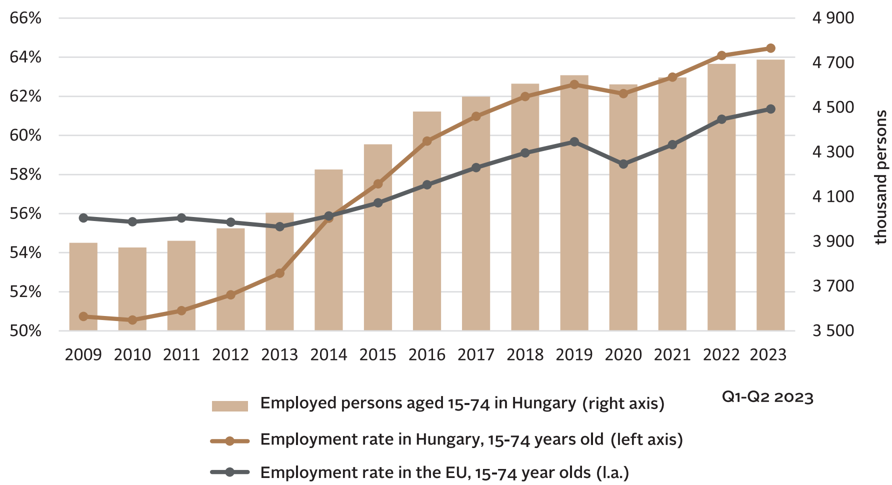
The main indirect, structural measures include:

- measures for a work- and knowledge-based economy:
    - employment-focused reform of labour market regulation;
    - active labour market policies such as public employment;
    - employment-focused restructuring of universities and vocational education;
    - the introduction of soft student loan schemes to support learning;
    - investment promotion grants and subsidised loan schemes to boost employment and modernise the economy;
    - restructuring the taxes supporting individual businesses;
- significant increases in the minimum wage and guaranteed minimum wage;
- well-timed measures that prove to be crucial, such as the conversion of residential mortgage foreign currency loans into HUF in early 2015.

The introduction of the Student Loan 2 in 2012, a low-interest loan scheme for higher education tuition fees – interest-free from 2017 – also reflects the spirit of meritocracy. It provides access to higher education for those who would otherwise not be able to afford the cost – complemented by the Student Loan 1 scheme, which is a freely disposable loan to help provide the necessary conditions for being a student (e.g. housing, equipment). This encourages investment in knowledge and provides intrinsically motivated students with the opportunity to develop, progress and thus become socially and upwardly mobile. The socio-economic benefits of student lending in Hungary are detailed by Duráczky (2023).

In the early 2010s, domestic economic policy was faced with very weak household purchasing power. One of the main reasons for this, apart from low wage levels, was the employment rate, which had been abnormally low since the change of regime, at around 50 percent, and was at the bottom of the EU ranking. As a result, Hungarian households had low disposable income, which was also responsible for the unfavourable deprivation indicators. The focus of economic policy was therefore on job creation and raising wage levels, and various incentives and measures were developed to this end, leading to a dynamic increase in the employment rate for the 15–74 age group, which approached 65 percent by 2023, exceeding the EU average. Only Malta's employment rate increased faster than Hungary's between 2010 and 2023.

Figure 8: The Hungarian employment rate has been above the EU average since 2015

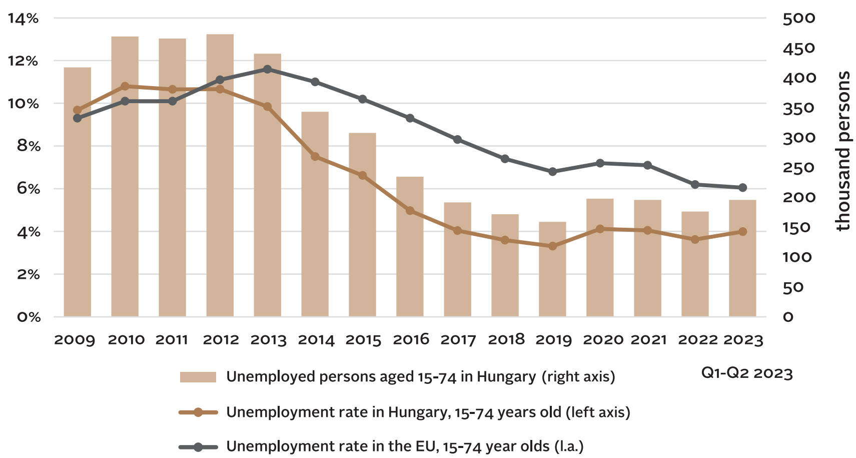


Source: Eurostat, HCSO, own ed.

Direct job subsidies and reductions in taxes on labour – both for employers and employees – have played a key role in stimulating employment. The effectiveness of the latter is demonstrated by the fact that, according to OECD calculations, the tax wedge in Hungary fell from 53.1 percent in 2009 to 41.2 percent in 2022. The flat rate PIT, indirectly boosting employment growth, and the reduction in the tax burden on employers (contributions, corporate tax, entrepreneurial burden) has played a major role in this. The latter is illustrated by the fact that, according to World Bank data, the tax burden of an average medium-sized enterprise fell by 16.6 percentage points to 37.9 percent of profits between 2011 and 2020, the lowest among the Visegrad countries.

As a "by-product" of the low employment rate, the high unemployment rate, which was above the EU average, also posed a major challenge for economic policy makers in the early 2010s. The generous social benefit system of the previous years, which did not encourage – but rather discouraged – work, played a key role. The result was a kind of benefit-based society, where potential workers – especially the lower skilled – were little or no better off if they took a job for at least minimum wage instead of unemployment benefit if they had the opportunity to do so despite the scarcity of jobs. At the same time, higher income groups also had less incentive to move up the income ladder as a result of the progressive tax system – in addition to being a hotbed of grey employment, resulting in a significant loss of tax revenue. The latter has been addressed by the introduction of the flat rate personal income tax, the former by the reform of the unemployment benefit system and the dynamic increase in the minimum wage and the guaranteed minimum wage. The minimum wage as a percentage of average gross earnings increased from around 36 percent in the years before 2012 to over 40 percent after 2012 (Molnár and Regős, 2023). The pivotal points of the reform of the unemployment benefit system were the reduction of the eligibility period for unemployment benefits, and thus the encouragement of an early return to employment, and the launch of a public employment programme (in a unified form) in 2013. This has contributed to the dismantling of the benefit-based society, driving the beneficiaries back into the world of work and then effectively promoting market employment by encouraging job creation by companies, thereby creating a work-based society. The results of all these measures are reflected not only in the employment rate but also in the unemployment rate, which has fallen from over 10 percent before 2013 to below 4 percent – thus almost full employment was reached.

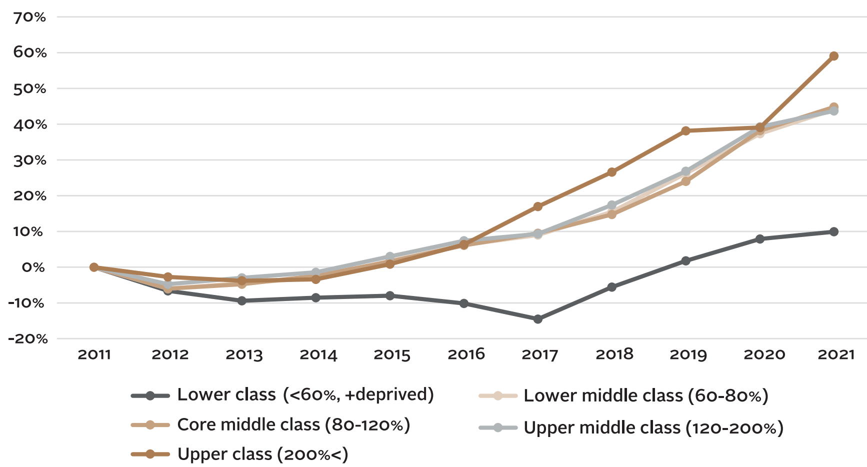
Figure 9: Unemployment rate in Hungary has already been better than the EU average since 2013



Source: Eurostat, HCSO, own ed.

By the end of the 2010s, labour shortages had emerged as a result of domestic economic policy measures targeting the labour market, which further fuelled the pace of wage increases. This is illustrated by the fact that, while disposable income per household still declined between 2011 and 2014 at 2011 prices for the middle class in income and material terms, it then started to increase significantly (Figure 10). Thus, disposable income in real terms for the middle class increased by 44 percent between 2011 and 2021. The income of the upper class increased slightly more and that of the lower class less. For the latter, the composition effect played a strong role in the prolonged decline in real terms. On the one hand, workers moving from the lower to the middle class are among the higher educated/earners, so that those remaining in the lower class have on average lower incomes. On the other hand, those who do not work are more likely to remain in the lower class, which is confirmed by the lower labour intensity of the lower class relative to the other strata.

Figure 10: Change in disposable income per household (2011=100%)



Source: EU-SILC, own calculation

However, as the width of the middle class has stabilised since 2017, the average disposable income of those remaining in the lower class has also started to increase in real terms. This is largely due to an increase in the share of labour income, which rose by nearly 7 percentage points between 2011 and 2021. Thus, the labour income of an average lower-class household increased by 39.2 percent in real terms over the period – while transfer income increased by only 4.2 percent. An examination of the structure of disposable income shows that the middle class has also experienced an increase in labour intensity, with the lower middle class standing out in this respect. For an average lower middle-class household, labour income accounted for only 57.0 percent of disposable income in 2011 and 77.5 percent in 2021. At the same time, the share of transfer income decreased from 42.7 percent in 2011 to 22.3 percent in

2021 – i.e. the role of public transfers in the structure of disposable income decreased significantly, while the role of labour income increased. For the middle and upper middle classes, there was a smaller improvement in the share of labour income over this period, of around 7 percentage points, but the starting value was still higher than for the lower middle class. All this leads us to an important conclusion: in Hungary, the middle class has widened significantly, while income inequality has narrowed, with significant real wage and economic growth.

Overall, therefore, the increased labour intensity resulting from targeted economic policy measures has contributed to a significant improvement in the situation of the Hungarian households, especially the middle class, which has widened by a factor of one and a half. As a result, there has also been a significant positive turnaround in income and wealth. Hungarian economic policy-makers do not take involuntary unemployment for granted, contrary to the orthodox economic view. In other words, full employment is the ideal and achievable state, giving everyone the opportunity to work and to improve the situation of themselves and their families through their diligence, knowledge and performance, i.e. Hungarian economic policy has moved our country closer to a meritocratic social system.

Conclusions

In the framework of our analysis, we examined the development of the middle class primarily from an income and wealth perspective, and in this context the results of Hungarian economic policy and its impact on the middle class. In the light of our research results, the hypothesis that the middle class in Hungary has become better off in the last decade can be justified – and this could not have happened without the economic policy measures based on Hungarian meritocratic ideas. There is still room for expanding the middle class: activating the potential labour reserve, which is difficult to mobilise, through targeted programmes could contribute to this, as could the further expanding and better targeting family support system as well.

In the context of our study, further areas of research can be identified such as the study of the middle class expansion from a spatial perspective and the analysis of characteristics based on occupational and educational characteristics, which will provide a more complete picture of this stratum in Hungary. Furthermore, we cannot ignore the need for a more in-depth international comparison. However, this is beyond the scope of this study. ■

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