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The Pension System and the Proposed State Budget for 2010 in Croatia

Marijana Bađun, MSc

In view of the warnings by international organizations and domestic experts about the need for changes to the pension system, the expectation has arisen in the public that the Government will make some moves in that area. However, the Proposed State Budget for 2010,¹ which the Government sent to Parliament on November 21, shows that for now there are to be no changes. Let us have a look at the figures.

The gap between contributions and expenditure

In 2010 it is planned to collect 19.87 billion kunas in pension insurance contributions, which is 1.4% less than in the plan for the budget for 2009. At the same time, planned expenditure on pensions and pension income amounts to 34.73 billion kunas, or 1.6% more than in 2009. Therefore the planned gap between contributions and expenditure in 2010 is 14.86 billion kunas, which is 6% more than in the plan for 2009. In other words, contributions only cover 57% of expenditure, whilst the deficit in the system has to be financed from other sources. Although in the Proposed Budget we have projections available for expenditure on pensions for 2011 (35.31 billion kunas) and 2012 (36.33 billion kunas) unfortunately there is no projection for pension insurance contributions.

Low ratio of expenditure on old-age pensions

The largest part of expenditure on pensions and pension income consists of expenditure on pensions on the basis of insurance, divided into three categories: old-age, disability and family pensions (Table 1). For 2010, this amounts to 27.32 billion kunas, or 79% of the total expenditure on pensions. Old age pensions on the basis of insurance (16.73 billion kunas) account for only 48% of the total expenditure on pensions and pension income.

¹ The analysis is based on the Proposed State Budget for 2010, available on:

http://www.vlada.hr/hr/naslovnica/sjednice_i_odluke_vlade_rh/2009/26_sjednica_vlade_republike_hrvatske.

Table 1 Expenditure on pensions (in billions of kunas)

| | Realized in 2008 | Plan for 2009 | Proposal for 2010 | Projection for 2011 | Projection for 2012 |
|---|-----------------------------|--------------------------|------------------------------|--------------------------------|--------------------------------|
| Pensions on basis of insurance | 22.98 | 24.25 | 27.32 | 27.86 | 28.69 |
| Old age | 14.34 | 15.17 | 16.73 | 17.07 | 17.57 |
| Disability | 4.91 | 5.16 | 5.89 | 6.01 | 6.18 |
| Family | 3.73 | 3.92 | 4.69 | 4.78 | 4.94 |
| <i>Ratio of pensions on basis of insurance in total expenditure on pensions (%)</i> | <i>70</i> | <i>71</i> | <i>79</i> | <i>79</i> | <i>79</i> |
| Pensions under more favourable terms | 6.92 | 7.00 | 7.26 | 7.30 | 7.49 |
| <i>Ratio of pensions under more favourable terms in total expenditure on pensions (%)</i> | <i>21</i> | <i>20</i> | <i>21</i> | <i>21</i> | <i>21</i> |
| Total expenditure on pensions and pension income | 32.92 | 34.18 | 34.73 | 35.31 | 36.33 |

Note: The total amount of pensions based on insurance and pensions under more favourable terms does not agree completely with the amount of the total expenditure on pensions and pension income given in the Table. The difference arises from the several items omitted here: 1) fees for payment of pensions; 2) pensions sent abroad; 3) supplements to pensions; 4) Christmas bonus to pension beneficiaries; 5) other pension income. See below in this text, part of which relates to lack of transparency.

Source: Proposed State Budget for 2010 and the author's calculations

The pressure from privileged pensions

The remainder of pension expenditure relates to beneficiaries who attained their right to a pension under more favourable terms. In 2010 it is planned to spend 7.26 billion kunas on these "privileged pensions" (3.8% more than in the plan for 2009), which is one fifth of the total expenditure on pensions and pension income (Table 2). Here the largest amount will be allocated to Croatian Homeland War Veterans (5.11 billion kunas), followed by the category of Veterans of the Second World War Resistance Movement (NOR), with a sum ten times lower (530 million kunas). When the expenditure is added up for all categories which expressly relate to the former system (Second World War Veterans (NOR), members of the former Yugoslav National Army (JNA), members of the Croatian Home Guard from 1941-1945, former political prisoners, members of the Executive Council of the Parliament, the Federal Executive Council and administratively retired civil servants), we arrive at the figure of 1.18 billion kunas. This is a significant burden on the budget, especially when we take into consideration the fact that 65 years have passed since the Second World War.

The number of beneficiaries of what are known as Homeland War Veterans' pensions is rising continuously (66,000 in October 2009 in comparison with 31,000 in 2003), and thereby expenditure on these pensions are also increasing. If we draw an analogy with the Second World War, the question arises how much the expenditure will be for Homeland War Veterans' pensions at this growth rate in, for instance, 2030. Precisely due to the tax burden on future generations it is important that Homeland War Veterans' pensions and all other pensions are received only by those who really deserve them.² The Government has recently taken certain steps regarding rights from pension insurance for Croatian Homeland War Veterans, which could slow down the trend of growth in the number of beneficiaries of these pensions.³

² For more information see Bađun, M. (2009) Beneficiaries of pensions who attained their right to a pension under more favourable terms, Newsletter, no. 44, Institute for Public Finances, <http://www.ijf.hr/newsletter/44.pdf>.

³ See the Decision on Promulgation of the Act on Amendments and Supplements to the Act on the Rights of Croatian Homeland War Veterans and Members of their Families (OG, 137/09).

Regarding the levels of privileged pensions, this year the Government has only reduced by 10% Parliamentary pensions, on which it is planned to spend 62 million kunas in 2010.⁴ But these are still significantly higher than the average pensions realized according to the Act on Pension Insurance (API). In October the average net pension for beneficiaries according to the API was 2,172 kunas, and a Parliamentary pension was 9,311 kunas, the pensions of regular members of HAZU (the Croatian Academy of Arts and Sciences) 8,308 kunas, for Homeland War Veterans 5,698 kunas and for Second World War Veterans (NOR) - 2,689 kunas.⁵

Table 2 Expenditure on pensions realized under more favourable terms (in millions of kunas)

| | Realized in 2008 | Plan for 2009 | Proposal for 2010 | Projection for 2011 | Projection for 2012 |
|---|-------------------------|----------------------|--------------------------|----------------------------|----------------------------|
| Homeland War Veterans | 4,759.2 | 4,800.0 | 5,110.0 | 5,170.0 | 5,380.0 |
| Second World War Veterans (resistance - NOR) | 587.4 | 563.0 | 530.0 | 507.0 | 489.0 |
| Croatian army members | 430.8 | 460.0 | 480.0 | 490.0 | 505.0 |
| Ministry of the Interior (police and judiciary) | 387.8 | 410.0 | 418.0 | 423.0 | 430.0 |
| Members of former JNA | 394.6 | 393.0 | 360.0 | 350.7 | 336.4 |
| Members of Croatian Home Guard 1941-1945 | 144.6 | 143.0 | 135.0 | 129.0 | 124.0 |
| Former political prisoners | 127.4 | 130.0 | 128.0 | 126.0 | 124.0 |
| Members of Parliament | 59.7 | 61.5 | 62.0 | 63.0 | 63.5 |
| Members of executive council of Parliament, Federal Executive Council and admin. Retired civil servants | 18.9 | 21.5 | 26.0 | 24.0 | 24.0 |
| Regular members of HAZU | 14.4 | 15.3 | 15.3 | 15.7 | 16.0 |
| Total expenditure on pensions under more favourable terms | 6,924.9 | 6,997.3 | 7,264.3 | 7,298.4 | 7,491.9 |

Note: the categories are in order of size of planned expenditure for 2010

Source: Proposed State Budget for 2010 and author's calculations

Low levels of voluntary pension savings

The state gives incentives for voluntary pension savings (3rd pillar) by paying out incentive funds and approving tax allowances. But in October 2009 the voluntary pension funds had 158,000 members, which is only 10% of pension insurees in the generational solidarity system.⁶ The figures are reflected in the Proposed State Budget: in 2010 it is planned to spend 59.8 million kunas on incentives for members of voluntary pension funds (10% less than in the budget plan for 2009). For the sake of comparison, the government plans to spend 3.5 times that amount (210 million kunas) on incentives for housing savings in 2010, and for administration and management of the pension system eight times more (474.4 million kunas). It is positive that this latter amount is 8.2% lower than in the budget plan for 2009. The largest part (70%) relates to expenditure on employees.

⁴ The Act on Reducing Pensions Established by the Act on the Rights and Obligations of Members of the Croatian Parliament. (OG, 36/09).

⁵ The Croatian Institute for Pension Insurance (2009) Statističke informacije, no. 3/2009.

⁶ www.hzmo.hr and www.hanfa.hr.

Lack of Transparency

It should be mentioned that the proposed budget does not separate out the three "privileged" categories found in the publications of the Croatian Pension Insurance Institute, which also include the pensions of members of the Croatian Defence Council (HVO).⁷ The number of beneficiaries of HVO pensions rose by October 2009 to 6,400 (in January 2008 it was 1,430).⁸ Furthermore, in the proposed budget it is also difficult to trace expenditure on pensions because for 2010 there has been a form of reorganization, so the positions "pensions sent abroad" and "pension supplements – 100 kunas + 6%" are not recorded separately but they are spread over other categories, as part of old-age, family and disability pensions. This probably explains the jump from 71 to 79% in the ratio of those pensions in the total pensions (Table 1). And finally it would certainly be desirable for it to be possible to compare the figures from the Report on the Financial Business of the Croatian Institute for Pension Insurance (HZMO) and the proposed state budget, since for instance in the Report it states that 32.78 billion kunas was spend on pensions and pension income in 2008, and in the proposed budget it states 32.92 billion kunas. Since by adding the Christmas bonus of 145 million kunas to the amount published in the HZMO publication the amount from the proposed budget is obtained, this probably explains the difference.

⁷ The others are two categories: 1) miners from the Istrian coal mine Tupljak d.d. Labin and workers professionally exposed to asbestos and 2) federal staff.

⁸ The Act to Ratify the Agreement between the Republic of Croatia and Bosnia and Herzegovina on cooperation in the field of the rights of victims of the war in Bosnia and Herzegovina, who were members of the Croatian Defence Council and members of their family came into force in 2006 (International Agreements 2/06). The relatively recent coming into force of this Act to some extent explains the growth in the number of beneficiaries of the pension in a short period of time.