Pension system in the Recovery and Resilience Plan

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Pension system in the Recovery and Resilience Plan

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The Croatian National Recovery and Resilience Plan 2021–2026, which was recently approved by the Council of the European Union[1], includes as one of the reform measures the improvement of the pension system through increased pension adequacy. The highlighted issues include redefining the survivor's pension model, increasing the minimum pension and second pillar pensions as well as prolonging working lives. In addition, the document announces the establishment of a working group for analysing the pension system. Even though the Recovery Plan touches upon important topics within the pension system, more emphasis should

[1] More precisely, the Croatian Government, at its session held on 29 July 2021, adopted the Conclusion acknowledging the Council Implementing Decision on the approval of the assessment of the recovery and resilience plan of Croatia.

have been placed on measures that could increase the motivation and ability of older workers to stay on the labour market for longer periods.

The labour market and social protection is one of the key components of the National Recovery and Resilience Plan 2021-2026 (hereinafter: Recovery Plan). This component also includes the pension system, for which the general objective was set as "further improvement of the pension system by redefining the survivor's pension model, increasing adequacy level of the minimum pension, and increasing second pillar pensions". In short, the fundamental reform measure is increasing pension adequacy.

Namely, the Recovery Plan states that, in the long term, the Croatian pension system is financially sustainable – its share in GDP will drop from 10.2% in 2019 to 9.5% by 2070 – however, the risk-of-poverty rate of older persons in Croatia is substantially higher than the EU average in the same period (30.1% and 16.5% respectively in 2019). It should also be pointed out that the gross replacement rate (gross pension divided by pre-retirement gross wage) in Croatia in 2019 stood at 32.5%, while the EU average was 46.2%. The European Commission's projections estimate that by 2070 this rate would drop to 22.8% in Croatia and 37.5% at EU level. The text below provides a review of the proposed measures for individual areas.

Longer working lives

The Recovery Plan, through amendments to work-related legislation on the termination of employment on grounds of age (65 years of age and 15 years of service, unless agreed otherwise by employee and employer), intends to encourage workers to remain employed for a longer period, which would positively affect their pension amounts. This reform also includes amendments to related legislation, e.g. the provision of the Mandatory Health Insurance Act, whereby the employer is obliged to cover full costs of sick leave for employees who have already reached the retirement age. The Recovery Plan also includes a proposal for amendments to the severance grant, which a worker is entitled to in case their employment contract has been terminated unilaterally by the employer. This amendment has been discussed with social partners, but the provision itself has not been clarified to much detail. Another objective is combatting non-declared work, i.e. avoiding payment of pension insurance contributions.

The Croatian Pension Insurance Institute's (Hrvatski zavod za mirovinsko osiguranje – HZMO) Statistical Review shows that 15,201 beneficiaries of old-age pensions and early old-age pensions were still working on a half-time basis in end-July 2021.[2] The highest share of these retired workers included: a) experts and scientists (18.5%), b) heads and members of legislative bodies, state bodies and executives (15.5%) and c) engineers, technicians and similar occupations (14.9%). These three groups make up almost half of beneficiaries of old-age and early old-age pensions who worked while receiving their pensions. They are followed by hospitality and commercial occupations (12.5%) and office and counter workers (11%). Men make up two-thirds of this number. This data reveals occupation groups which show the largest interest for remaining in

[2] Applicable only to users whose pensions have been defined pursuant to the general regulation (Pension Insurance Act - ZOMO).

the labour marker, even after reaching the retirement age. They must be well-paid positions with favourable working conditions.

The Recovery Plan focuses on workers who reached the retirement age and wish to remain employed but lacks any suggestions for retaining the 55-64 age group on the labour market until the age of 65. Increasing the employment rate of persons in this specific age group is a very important task for Croatia as Eurostat data shows that Croatia sits near the bottom of EU rankings when it comes to this indicator (45.5% as opposed to the EU average of 59.8% in 2020). According to the Aging Report, the average effective labour market exit age in Croatia in 2019 stood at 62, while the EU average was 63.8. Estonia, Italy and Sweden were the only countries where this age was above 65, Slovenia reported same values as Croatia, while Luxembourg and Slovakia were the only two countries with even lower values.

Prolonging working lives is extremely difficult, not only in Croatia, and requires much more effort than merely amending work-related legislation or mere technical changes to the pension system. The proposal for extending the retirement age to 67 was severely opposed from various sides and has not been included in the Recovery Plan. However, there are other ways of prolonging working lives. Research conducted in Croatia has shown that early retirement is opted for more frequently by workers with lower education levels, poorer health, lower life quality or those employed in the private sector, which is probably a reflection of working conditions. Croatia does not bode well in any of these areas, which is why an integral approach is necessary with numerous measures that would stimulate older workers to remain in the labour market as well as increase the employers' willingness to retain them.[3]

Survivor's pension and minimum pension

Amendments to the Pension Insurance Act (ZOMO) plan to redefine the survivor's pension model. Criteria and parameters of the new model should be made public in December 2021, following a conducted analysis. The working group for the re-assessment of the survivor's pension model was formed in February 2021. The objective of the reform is to increase social security by enabling the beneficiary to use a part of their deceased spouse's/domestic partner's pension alongside their own pension, also taking into account the spouse's/domestic partner's age. By defining the upper limit on the sum of these two pensions, this measure would be primarily focused on lower-income beneficiaries. The proposal also includes changing the pension factor for calculating the survivor's pension level, which would increase the average survivor's pension amount by 10-15% (around HRK 320 in the initial year), while the share of survivor's pension in the average net wage would go up from 35% to around 40%. As pointed out, this should ensure a "fairer" pension calculation method.

The average survivor's pension amount for beneficiaries that qualified for it under ZOMO in June 2021 equalled HRK 2,096.

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[3] An example of such an integral approach can be found in the report "Major Future Economic Challenges" published in June 2021, which was prepared by more than twenty internationally acclaimed scientists led by two highly renowned experts – Olivier Blanchard and Jean Tirole. The report was commissioned by the French President.

However, there are currently 18 groups of beneficiaries that are entitled to survivor's pension pursuant to special regulations (see HZMO's Statistical Review, p. 42). Having mentioned the concept of "fairness", it should be highlighted that the average survivor's pension for the category "members of Croatian Parliament, Government members, Constitutional Court members and Chief State Auditor" stood at HRK 8,223, while the average survivor's pension for fellows of the Croatian Academy of Sciences and Arts equalled HRK 7,176. It goes without saying that the survivor's pension should not be the starting point for any amendment to pension-related legislation pertaining to the above categories. We cannot highlight enough the relentless refusal of all previous governments to revise special regulations in the pension system.[4] Even if the financial impact of these changes would be minimal, its symbolic effect would be major.

The Recovery Plan also provides for pensions of beneficiaries with minimum pension to rise in accordance with economic capacity. As of 1 January 2023, the minimum pension should increase by 1.5%, followed by another 1.5% increase as of 1 January 2025. Additional funds should be provided in the State budget for this to take place. In June 2021, 270,359 beneficiaries received the minimum pension in the average amount of HRK 1,738, which was HRK 619 higher than the average pension calculated on the basis of their pension contribution period and wages earned. Amendments to ZOMO

[4] See the Institute of Public Finance's Newsletter from 2009. It is interesting to note that special regulations enable retired university professors bearing the Professor Emeritus title to receive life-long monthly benefit from their university's funds. For instance, the benefit defined by the University of Rijeka stands at 20% of a full professor's gross wage. The list of Professors Emerita at the University of Zagreb is available here.

which would lead to a rise in the minimum and survivor's pension should come into force by the end of Q1 2023.

Second pension pillar

The Recovery Plan states the second pension pillar has achieved "respectable results", without providing any further explanation. The Plan summarises the 1 January 2019 amendments to the Mandatory Pension Funds Act, especially highlighting extended possibilities of mandatory pension funds (OMF) to invest in various types of assets. According to the data presented in the Recovery Plan, around 70% of OMF's assets is comprised of bonds (50% being the statutory minimum), which means that 10-20% of OMFs' portfolio is available for more profitable assets.[5] The OMFs' higher yield rate would lead to more adequate second pillar pension levels. The Plan thus suggests "stronger involvement of pension funds in infrastructural projects and higher investment into state-owned enterprises". Apart from higher yield rates, this should result in "better corporate management, risk dispersion and greater efficacy of companies under partial or full state ownership." OMFs are already able to invest in infrastructural projects on Croatian territory under the condition that a project has been labelled as infrastructural by the Government, which is yet to be the case.[6]

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[5] According to HANFA's June 2021 data, the share of national state bonds in OMFs' net assets stood at 58.8%, the share of international state bonds equalled 3.1%, while the share of national corporate bonds was 1.4%. This is lower than the 70% reported in the Recovery Plan, which means that the bond share has dropped in the meantime. The OMFs' investment structure deserves a separate Note.

The Recovery Plan announces the launch of an international tender for recruiting independent experts that would draft an expert study on the cost-effectiveness of OMFs' investments into state-owned companies undergoing or planned to undergo privatization. This study constitutes "substantial cost of measure", with the total cost of all activities related to the pension system as listed in the Recovery Plan estimated to HRK 22.66 million. By the end of Q1 2024, the Government should adopt a conclusion on accepting the Report on the Conducted Analyses of the Cost-effectiveness of OMFs' Investments.

Since the Government recommends OMFs to invest more into state-owned enterprises, we hope that it took into account the analysis of corporate management in these enterprises that the Government commissioned from OECD and that was published in June 2021. Namely, the conclusions and recommendations arising from the OECD's analysis are less than optimistic. Besides numerous defects in the regulatory framework, problems with ownership structure, ambiguities related to the scope of commercial and non-commercial objectives, the fundamental shortcoming is the limited role of supervisory boards, which are neither independent nor responsible for corporate supervision. "In practice therefore, many SOEs operate either as extensions of their ownership ministries or at the discretion of their executive management (whose representatives are appointed by the state rather than the supervisory boards)." It seems that we should first solve all problems highlighted by the OECD, although a detailed analysis of the operation of state-owned enterprises would also be valuable.

The Recovery Plan reminds us that the National Development Strategy 2020-2030 anticipates the second pension pillar contribution rate to rise “depending on fiscal capacities, after the capital market improves and the state of Croatia’s budget becomes more favourable”. In addition, it keeps repeating that citizens’ financial literacy should be improved in order to increase their personal responsibility and motivation for retirement saving. Potential for economic growth should also be intensified, including employment rates, which would lead to higher pension contribution payments.

Analysis of the pension system

Q2 2022 will see the establishment of the Working Group for the analysis of the pension system, which should consider the options for improving the pension system in order to increase pension adequacy and the sustainability of the pension system. The Working Group will particularly look into the effects of the amendments to the pension system that came into force on 1 January 2019, while its conclusions would lead to new amendments to ZOMO by the end of Q4 2025.

In conclusion, it seems that the Croatian pension system is like a patient with a chronic illness. We keep analysing it, we argue over which therapy is better, shouting accusations at each other, but the patient is not getting better. We keep trying out new medications, the majority of which show serious side-effects and poor performance. Yet we keep wondering why the patient is still ill, failing to acknowledge that they had been given tasks they were unable to complete and that should not have been given to them in the first place. Is there hope? Perhaps we should make peace with the fact that we could alleviate their symptoms, but that full recovery is unlikely? However, even with expectations set much lower, we still need to provide the best form of "treatment".

It seems that the Recovery and Resilience Plan should have placed more emphasis on older persons and the labour market, employees' health, continuous professional training, working conditions and differences in workers' life expectancies. In addition, we should seriously reconsider the transparency and fairness of our pension system.