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Croatian Pension System and the Economic Crisis

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The Croatian pension system has been the cause of growing concern for both the public and policy makers. By using the data from the latest publications of the Croatian Pension Insurance Agency (CPIA), we will show that the economic crisis has even worsened the current problems in the pension insurance system.¹

Expenditure and revenue. Let us start with the pension system expenditure. The share of expenditures for pensions and other retirement benefits in GDP increased to 10.33% last year, from 9.58% in 2008. This was due to a fall in GDP, but also a rise in pension expenditures. More specifically expenditures for pensions and other retirement benefits went up by HRK 1.6bn in 2009, from HRK 32.8bn in 2008 to HRK 34.4bn in 2009. Concurrently, contribution revenues dropped by HRK 316m, leading to a gap between the contribution revenues and expenditures for pensions and other retirement benefits of HRK 14.6bn in 2009. This represents a 16% increase relative to 2008 when the difference amounted to HRK 12.6bn. As a result of this, direct budget expenditures for pensions and other retirement benefits went up by HRK 2bn in 2009, from HRK 13.2bn in 2008 to HRK 15.2bn in 2009. Revenues from the budget accounted for 44% and contribution revenues for 56%² of total CPIA revenue.

Pension beneficiaries and insured persons. Let us see what happened to the numbers of pension beneficiaries and insured persons in the pay-as-you-go system. In the first half of 2010, the system dependency ratio was 1.28, falling to the lowest level recorded in Croatia since 1990, when it stood at 3 insured persons per pensioner. During the economic crisis, the number of pensioners went up, whereas the number of insured persons declined. The data are shown in Table 1.

¹ The analysis is based on the latest CPIA publications: „Statistical Information“, No. 2/2010 [<http://www.mirovinsko.hr/default.asp?ID=2447>] published on 16 July 2010, and "Report on the Work and Operations of the CPIA in 2009" [<http://www.mirovinsko.hr/default.asp?ID=2424>].

² Revenues from the budget are used for financing the so-called privileged pensions, compulsory insurance benefits based on capitalised savings, the pension supplement of HRK 100 plus 6% of average pension paid in June 1998 and liabilities arising from the Act on Increasing Pensions for the Purpose of Obviating Differences in the Level of Pensions Granted in Different Periods and Act on Supplement to Pension Granted Pursuant to the Pension Insurance Act.

Table 1 Pension beneficiaries and insured persons

| | 31/12/2008 | 31/12/2009 | 30/6/2010 | 1/1-30/6/2010 average |
|---|-------------------|-------------------|------------------|----------------------------------|
| Insured persons | 1,148,290 | 1,173,814 | 1,187,509 | 1,181,711 |
| Insured persons in the pay-as-you-go system | 1,604,848 | 1,530,233 | 1,532,633* | 1,507,342 |
| System dependency ratio | 1.40 | 1.30 | 1.29 | 1.28 |

*The number of insured persons increases during the summer months as a result of employment growth.

Source: CPIA

It is interesting to see the pattern of growth in insured persons (Table 2). Total growth was 2% during 2009, with the largest increase recorded in the number of early retirement pension beneficiaries (20%). The same was true for the first half of 2010 – the fastest growth was seen in early retirement benefits (12%). This was paralleled by an increase in the number of lowest pension beneficiaries pursuant to the Act on Croatian Homeland War Veterans (ZOPHBDR) and their family members (35% and 5% respectively). The number of disability pension beneficiaries in the category including the Croatian war veterans, Croatian Army and Croatian Defence Council (CDC) went up by 13% during 2009 (according to the CPIA classification). The bulk of them were homeland war veterans. The total number of disability pension beneficiaries was about 323,000, 27% of total pension beneficiaries.

Table 2 Pension beneficiary structure

| | 31/12/ 2008 | 31/12/ 2009 | 2009/2008 index | 30/6/ 2010 | 30/6/2010 / 31/12/2009 index |
|---|------------------------|------------------------|----------------------------|-----------------------|---|
| Pension beneficiaries under the PIA* | 1,070,956 | 1,088,036 | 102 | 1,100,240 | 101 |
| Old age | 517,626 | 514,501 | 99 | 514,594 | 100 |
| Early retirement | 69,743 | 83,397 | 120 | 93,574 | 112 |
| Disability | 246,566 | 252,345 | 102 | 253,786 | 101 |
| Survivors' | 237,021 | 237,793 | 100 | 238,286 | 100 |
| Homeland war veterans, Croatian Army and CDC | 77,334 | 85,778 | 111 | 87,269 | 102 |
| Old age | 1,983 | 2,113 | 107 | 2,107 | 100 |
| Lowest pension (ZOPHBDR) | 215 | 290 | 135 | 304 | 105 |
| Disability | 62,123 | 70,253 | 113 | 71,704 | 102 |
| Survivors' | 13,013 | 13,122 | 101 | 13,154 | 100 |
| Total | 1,148,290 | 1,173,814 | 102 | 1,187,509 | 101 |

* Pension Insurance Act.

Source: CPIA

The CPIA also publishes data on pension beneficiaries who have acquired the right to pension for the first time in a given period. Table 3 confirms the data from Table 2: the largest increase (by 76%.³) in the first half of 2010, relative to the same period last year, was recorded in new early retirement pension beneficiaries. This suggests that early retirement is used for resolving the problem of redundant labour, i.e. that it is not very often that employees retire early by choice.

³ An important difference between Table 2 and Table 3 is that the former also takes into account the cessation of pension payment, i.e. it shows the real status. Table 3 shows the inflow of new beneficiaries.

Table 3 Pension beneficiaries under the PIA who have acquired the right to pension for the first time in the period 1 January-30 June (as at 30 June)–new beneficiaries

| | 1/1 – 30/6/2008 | 1/1 – 30/6/2009 | Index | 1/1 – 30/6/2010 | Index |
|----------------|----------------------------|----------------------------|--------------|----------------------------|--------------|
| Old age | 11,440 | 7,890 | 69 | 9,223 | 117 |
| Early retirem. | 3,959 | 5,425 | 137 | 9,554 | 176 |
| Disability | 7,656 | 6,725 | 88 | 5,206 | 77 |
| Survivors' | 8,035 | 7,530 | 94 | 6,747 | 90 |
| Total | 31,090 | 27,570 | 89 | 30,720 | 111 |

Source: CPIA

As shown in Table 2, over 2009, the number of the so-called veterans' pensions grew faster than the number of pensions under the PIA. Table 4 shows the three largest categories of beneficiaries who have acquired the right to pension under favourable conditions, i.e. pursuant to special regulations: Croatian homeland war veterans, NLW participants and the Croatian Home Guard Army members. The increase in the so-called veterans' pensions was lower in the first half of 2010 (1,436) relative to the same period last year (3,193). Total expenditures for the „privileged pensions“ rose by 4.2% in 2009 relative to 2008 (9.7% in 2008 relative to 2007).

Table 4 Pension beneficiaries who have acquired the right to pension under favourable conditions, i.e. pursuant to special regulations

| | 31/12/2008 | 30/6/2009 | 31/12/2009 | 30/6/2010 |
|--|-------------------|------------------|-------------------|------------------|
| Croatian homeland war veterans | 61,301 | 64,494 | 67,714 | 69,150 |
| NLW participants | 45,965 | 43,557 | 41,679 | 39,611 |
| Members of the Croatian Home Guard Army, 1941-1945 | 21,455 | 20,481 | 19,678 | 18,738 |

Source: CPIA

Pensions. Average pension pursuant to the PIA stood at HRK 2,169 in December 2009, up 2% from the previous year; the average pension-to-average-net-wage ratio was 40.5% (39.3% in 2008). In June 2010, average pension pursuant to the PIA amounted to HRK 2,177, with old-age pension standing at HRK 2,423, early retirement pension at HRK 2,258, disability pension at HRK 1,939 and survivors' pension at HRK 1,868. The differences between these categories are minor, particularly given the average service periods which were 31.7, 34.7, 23.5 and 27.3 years for old-age, early-retirement, disability and survivors' pensions respectively. It is interesting to note that late in 2009, only 18% of total old-age pension beneficiaries accumulated the service periods of 40 years or more.

Government programme. Within its economic recovery programme, the Government has proposed several measures relating to the pension system:

- 1) the revision of the „privileged pensions“ and their reduction, as well as making arrangements for the gradual abolishment of certain pension categories;
- 2) a gradual adjustment of the statutory early and regular retirement ages;
- 3) changing the rules for early retirement and its financial penalisation;
- 4) a gradual increase in contributions for the second-pillar of the pension system;
- 5) the recognition of employer's contributions to the third pillar as allowable costs;
- 6) the reduction of administration fees for the second-pillar of the pension system.

So far, the measure under 1 has been partly carried out (by passing an Act on Reducing Pensions Determined or Realised under Special Pension Insurance Regulations, Official Gazette No. 71/10), and the measure under 5 has been completed (an Act on Amendments to the Personal Income Tax and Corporate Income Tax Acts, Official Gazette 80/10 has been passed). The Government is currently working out the measure under 3, which might have influenced the growth in new early retirement pension beneficiaries over the first half of 2010.

As the Croatian pension system has long been used as a means of resolving social and economic problems, it seems that the proposed measures will only slowly change the situation in which there is almost one employee per pensioner in Croatia. Therefore, parallel reforms are called for in the labour market, consisting in:

- 1) the provision of appropriate financial incentives for remaining economically active;
- 2) the offering of attractive and flexible work contracts to elderly employees (temporary or part-time jobs);
- 3) increasing the employment opportunities for elderly employees through life-long education;
- 4) generally raising the economic activity rate of the population, etc.

At the same time, there is a need for changes in the health care policy, because, according to the World Health Organisation, Croatia's standardised mortality rate is above the EU-15 average for all the major uninfected diseases, like vascular diseases, cancer, chronic respiratory diseases and diabetes. Health has a significant influence on the length of a person's active life.

And finally, the institutional environment in the country should be such as to stimulate economic growth and, consequently, employment.