



Croatia: Government remains committed to second pension pillar in face of public debate

ESPN Flash Report 2018/12

IVANA VUKOREPA – EUROPEAN SOCIAL POLICY NETWORK

MARCH 2018

Since 2002, the Croatian pension system consists of three pillars. However, every few years there is a recurring policy debate questioning the need for the second pension pillar, which is a mandatory fully funded defined contribution scheme. The Government recently proposed amendments to the second pillar, suggesting it is committed to keeping it, even in the face of costs, adequacy concerns and financial market risks.

LEGAL NOTICE

This document has been prepared for the European Commission. However, it reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

Description

The Croatian pension system is a mixed system consisting of three pillars. The first pillar is a pay-as-you-go (PAYG) defined benefits scheme financed by contributions, although 48% of the current deficit is financed from the State Budget. There has been a constant increasing trend in pension costs in the first pillar (in 2017, the first pillar pension costs stood at 37.9 billion HRK, approximately €5 billion) as well as in the pension system's deficit (which reached 16.2 billion HRK in 2017, approximately €2.2 billion). The second pillar is a mandatory fully funded defined contribution scheme, while the third pillar is a voluntary supplementary scheme including both open funds for citizens and closed funds sponsored by employers, trade unions or other professional associations. Croatia has no specific occupational defined benefit pension schemes. Pursuant to the Act on Contributions the total contribution rate for mandatory pension insurance is normally 20%. Persons covered only by the PAYG scheme pay all contributions only to the first pillar, while persons insured under both pillars pay 15% to the first pillar and 5% to the second pillar. Since 2017, due to a tax reform, persons receiving non-regular income from employment and self-employment (so-called "other income") pay pension contributions at a reduced rate (10% instead of 20%).

Since the majority of second pillar members do not yet qualify to receive an old-age pension, there has been a constant increase in the pension funds' assets (at the end of 2017 these stood at around 92 billion HRK, approximately €12.3 billion). Hence, this pool of assets provokes considerable public interest.

Every few years there is a recurring policy debate on the justification of the existence of the second pension pillar (these occurred in 2009-2010, in 2013-2014, and the latest in 2016 and 2017). By referring to reform examples in Bulgaria, Hungary and Poland, some voices have advocated abolition of the second pillar (and transfer of funds to the first pillar), or have called for a reduction or freezing of further payments into the second pillar and for these to be transferred into the voluntary, third pillar.

Heated public debates have occurred between proponents and opponents of the abolition of the second pillar, covered regularly on television and in daily newspapers.

On 1 February 2018, the Croatian Government proposed some legislative amendments regarding the second pillar (mainly concerning the mandatory pension fund's investment opportunities), thus showing its intention to stay committed to a two-tier mandatory pension system.

Outlook & commentary

The Union of Croatian Pensioners (*Sindikata umirovljenika Hrvatske*), some scholars and some politicians have advocated abolition or reduction of the second pillar, primarily to reduce explicit public debt and free up more resources for current pensioners. Their arguments seek to resolve a clash of intergenerational interests by rejecting the partial privatisation (individualisation) of the pension system. Another argument against the second funded pillar is that it is a "risky business", far too exposed to the "casino economy", and thus too volatile to be suitable as a source of adequate pensions.

Opponents of the nationalisation and/or reduction of the second pillar have pointed to several arguments against this move. Firstly, such a reform would reverse the systemic reforms implemented so far. Secondly, any partial and rapid change of the system, without looking at the short-term and long-term consequences, could distort the original reform concept, creating insecurity and distrust amongst citizens, and opening the door to new "injustices" and thus social pressures to correct them. Thirdly, abolition or reduction of the second pillar could create even more problems in the future. The short-term benefits would be a temporary reduction in explicit public debt, but the long-term

damage could be much greater. Implicit public debt would increase. Further, such a move could cause citizens to lose trust in governments again, and could open an additional path to the grey economy. In legal terms, due to provisions of Articles 79 and 106 of the Act on Mandatory Pension Funds, the abolition of the second pillar would represent the nationalisation of private property. In the socio-economic sense, it would also be an additional burden for future generations.

It should be also pointed out that pension fund managers as well as some scholars have been proposing increases in pension contribution rates in favour of the second pension pillar. Such a proposal is also worrying because it could contribute to an increase in transitional costs (the cost of switching from a one-tier to a two-tier system). In addition, it could make the pension system more exposed to market risks.

Although the debate about the abolition of the second pillar is likely to continue, it would be more useful to direct and focus future discussions on measures for the improvement and fine-tuning of both the first and second pillars, as two complementary schemes with different types of risk exposure, both of which must function properly in order to achieve adequate pensions within a sustainable mandatory pension system.

Further reading

Petition against abolition and freezing of the second pension pillar, January 2016:

<http://net.hr/danas/hrvatska/peticija-domacih-ekonomista-protiv-zamrzavanja-uplata-u-drugi-mirovinski-stup/>

Bejaković, Predrag. Zašto treba održati II. mirovinski stup [Why should we keep the second pension pillar], *Radno pravo*, No. 2, 2016, pp. 57-63.

Bežovan, Gojko. Drugi je mirovinski stup opasno kockanje, svi su pobjegli osim Hrvatske [The second pillar is dangerous gambling, everyone fled except Croatia], *Večernji list*, 14.11.2017, <https://www.vecernji.hr/premium/mirovine-1207537>

Round Table: "The Croatian Pension System and Sustainability of the Second Pillar", Zagreb, Faculty of Law University of Zagreb, 21.10.2016, research papers will be published in "Revija za socijalnu politiku" [Croatian Journal of Social Policy], in one of the forthcoming issues in 2018.

Round Table: "Should the 2nd pension pillar be abolished or frozen", Novinarski dom, organised by the periodical "Radno pravo" [Labour law], Zagreb, 27.1.2016.

Proposal for amendments to the Mandatory Pension Funds Act, 1.2.2018:

<http://www.sabor.hr/prijedlog-zakona-o-izmjenama-i-dopunama-zakona0185>

Authors

[Ivana Vukorepa](#) (University of Zagreb, Faculty of Law)

Note: The author of this report participated in the public debate in favour of a mixed system, pointing to the necessity of improving both pillars. In this Flash Report, the author has tried to present all the varied arguments put forward in the debates.