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Financing social protection

Croatia

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**ESPN Thematic Report on
Financing social protection**

Croatia

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Summary

In Croatia the share of gross expenditure on social protection in GDP amounted to 21.3% in 2016 (compared with 18.8% in 2008). The highest share was in 2014 and 2015 – 21.8%. The growth in the share of gross expenditure on social protection in the 2008-2016 period can be attributed more to the drop in GDP than to the growth of real social protection expenditure, which rose on average by 0.5% annually. A major increase in the share of social protection expenditure in GDP was recorded in the 2008-2010 period, because of a huge drop of GDP and economic activity (GDP in 2010 was 9.8% lower than in 2008). On the other hand, declining economic activity resulted in a fall of the number of employed persons and a substantial reduction in social contributions (the employment rate fell from 60% in 2008 to 52.5% in 2013). The largest share of social protection expenditure in 2016 belonged to the old age function (34.2%); the share of the sickness/health function amounted to 33.4%, while the share of all other functions was 32.4%.

The social protection system has been financed mostly through compulsory social contributions paid by employers or employees (58.7% of the overall social protection expenditure in 2016) and general government contributions (38.5% in 2016). However, in the 2008-2016 period a decreasing trend was observed in the share of social contributions and an increasing trend in the share of general government contributions – as a whole, and in the main functions of social protection (old age, sickness/healthcare, disability, survivors). There was a decline in the shares of all types of social contributions (paid by employers, employees and the self-employed) in total social protection receipts.

The main source of financing for the old age function is social contributions, whose share fell from 66.8% in 2008 to 59.1% in 2015. The shares of social contributions in financing of the survivors and disability functions also fell in the 2008-2015 period. In order to ensure the financial sustainability and adequacy of the pension system, the government has implemented four categories of measures: 1) an increase in pensions for new beneficiaries in the two-pillar model; 2) a reduction in pensions during the recession, and greater penalties for early retirement; 3) changes in the classification of pensions (channelling savings from the fully funded to the pay-as-you-go [PAYG] pillar, or conversion of disability into old-age pensions); and 4) indexation of pensions (absence of indexation during the recession and change of the indexation formula).

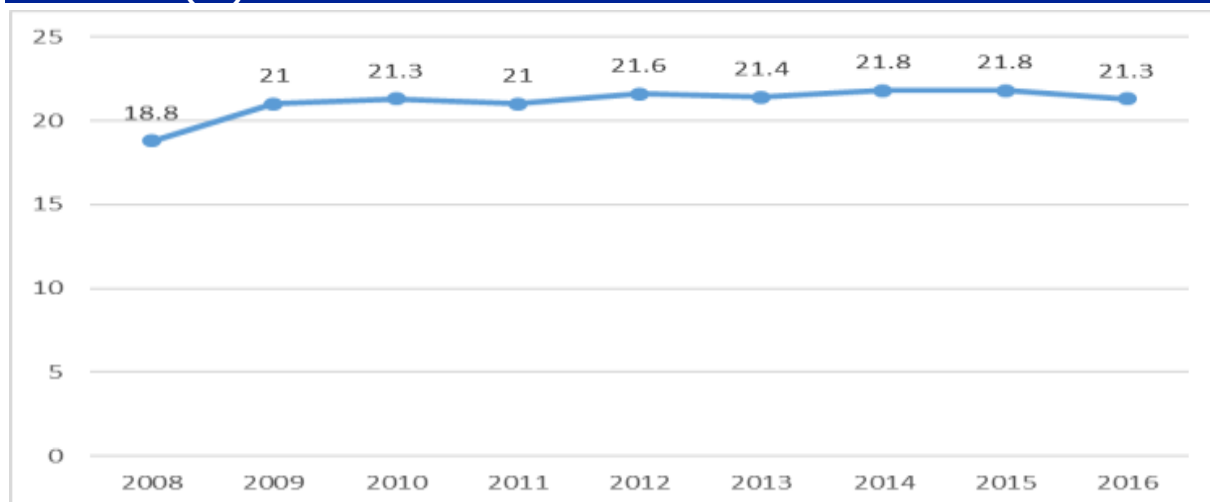
More than 80% of total financing for the sickness/healthcare function comes from social contributions. However, the trend for this function is very similar to the general trend for social protection: the share of social contributions is declining and the share of general government contributions and other receipts is increasing. Unemployment benefits prior to 2019 were financed through a mandatory unemployment insurance programme, but at the end of 2018 the unemployment insurance contribution (1.7%) and the contribution for accidents at work and occupational diseases (0.5%) were abolished, and instead the health insurance rate was increased from 15% to 16.5%.

Negative demographic trends due to the emigration of the younger population, a low employment rate and weak economic growth make the pension system hardly financially sustainable. The government should make more effort to collect contributions and to control contribution evasion. In the healthcare system, we suggest that the government should increase supplementary health insurance paid premium to the Croatian Health Insurance Fund by 20%, with an improved means test; and that it should improve the efficiency and effectiveness of this sector. In addition, it is important to increase government contributions towards means-tested benefits in the social exclusion and family/children functions, and to use EU funds to improve the availability and affordability of childcare services in underdeveloped regions.

1 Current levels and past changes in financing social protection

The share of gross expenditure on social protection in Croatian GDP amounted to 21.3% in 2016 (the highest share was in 2014 and 2015 – 21.8%) (Figure 1). Among the member states which acceded to the EU after 2004, only Slovenia's share of gross expenditure on social protection in GDP is higher than that of Croatia. Also, the ranking of Croatia among the EU member states does not change significantly if the share of net expenditure on social protection in GDP is analysed, because the difference between gross and net expenditure in different years amounts to only 0.3% of GDP.

Figure 1: Share of gross expenditure on social protection in total GDP, Croatia 2008-2016 (%)



Source: Eurostat, ESSPROS database.

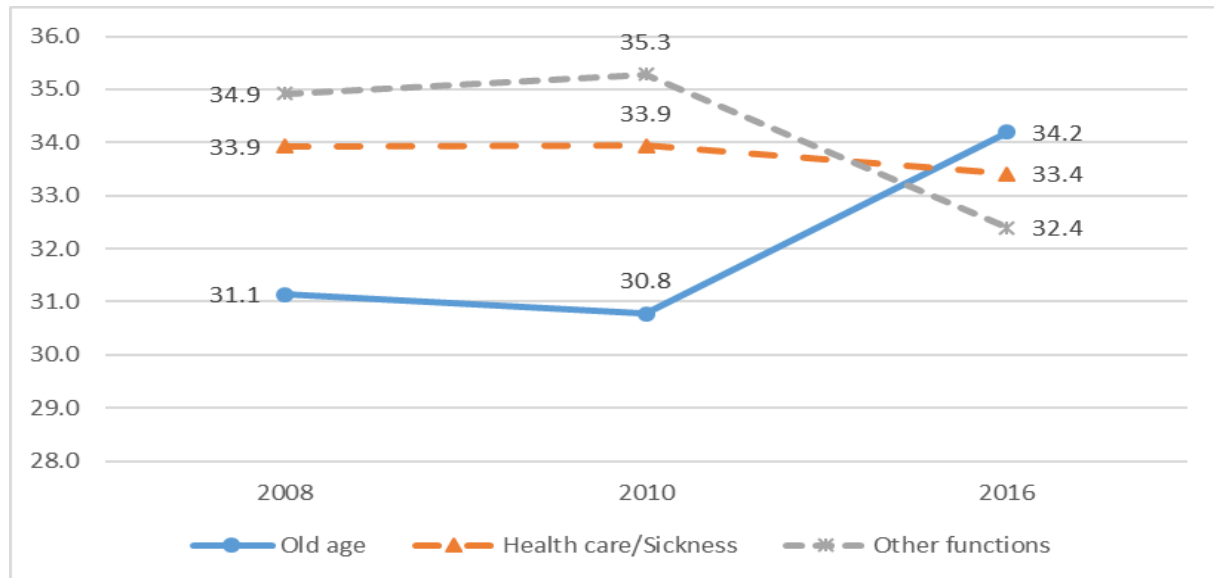
The share of gross expenditure on social protection in GDP in 2016 was 2.5 percentage points higher than in 2008, when it was 18.8% (data on social protection spending in Croatia according to the ESSPROS [European System of integrated Social PROtection Statistics] methodology for the years prior to 2008 are not available). In the 2008-2016 period, real social protection expenditure rose on average by 0.5% annually. However, the growth in the share of gross expenditure on social protection in the period referred to could be attributed more to the drop in GDP than to the growth of real social protection expenditure. After the initial period of the recession, gross expenditure on social protection in 2010 was 2.5 percentage points higher than in 2008, which can be explained by the large fall of GDP at the time. According to Eurostat (Figure A1 in the Annex), GDP in 2010 was as much as 9.8% lower than in 2008. Apart from that, this upsurge in the share of social expenditure in GDP was in part accounted for by the increasing costs of social protection in real terms (in the 2008-2010 period real social protection costs rose on average by 1.2% annually). After 2010 the share of gross expenditure on social protection in GDP increased slightly in the period 2012-2015, and in 2016 it went back to the level of 2010. In the 2010-2016 period, real social protection expenditure rose on average by 0.3% a year.

In the whole 2005-2016 period, there was a reduction in the share of expenditure on means-tested benefits in total social protection expenditure – from 6.7% in 2005 to 4.9% in 2016 (a fall of 1.8 percentage points). The largest fall was recorded in 2005-2008, by 1.5 percentage points from 6.7% in 2005 to 5.2% in 2008, after which only a small further decrease was observed. This trend was accompanied by a significant increase in the share of expenditure on non-means-tested benefits (such as pensions) in the period concerned.

As regards the structure of social protection expenditure by ESSPROS functions in 2016, the largest share belonged to the old age function (34.2%); the share of the sickness/healthcare function amounted to 33.4%, while the share of all other functions was 32.4% (Figure 2). Over the 2008-2016 period the share of sickness/healthcare in total

social protection expenditure was very stable (33.9% in 2008 and 2010, 33.4% in 2016), while the share of expenditure on old age and other functions changed more significantly.

Figure 2: Breakdown of gross expenditure on social protection in Croatia by functions, 2005-2016 (% total expenditure)



Source: Eurostat, ESSPROS database.

The only countries in the EU spending more on healthcare (in proportionate terms) through private (voluntary) health insurance than Croatia are France, Ireland and Slovenia. Nestić and Rubil (2014), using World Health Organization (WHO) 2010 data, have estimated that the share of private expenditure on healthcare in Croatia is around 15% of total healthcare expenditure: but they suggest that this level is actually somewhat lower than expected, given the significant negative correlation between the level of economic development and the share of private expenditure on healthcare. They conclude that the Croatian level of private expenditure on healthcare is closer to that in the most developed EU countries such as Denmark and Luxembourg suggesting that the share of public expenditure for health care is higher than expected according to the level of economic development.

The sustainability of the healthcare system in Croatia mainly depends on the following key factors: population ageing; technological advances in healthcare equipment and instruments; pharmaceutical industry innovations; the complexity of the governing structure and a multitude of different stakeholder interests (such as doctors and other medical professionals, the pharmaceutical industry and national/local policy-makers); and the high expectations of Croatian citizens, in terms of a high standard of services provided by a (historically) publicly funded healthcare sector. Given the above, it will be very demanding to ensure long-term sustainability in the financing of the healthcare sector.

The share of spending related to old age in total social protection expenditure fell slightly from 31.1% in 2008 to 30.8% in 2010, only to increase to 34.2% by 2016 (see Figure A2). On the other hand, the share of gross expenditure on 'other' functions first increased from 34.9% in 2008 to 35.3% in 2010, only to drop to 32.4% in 2016. Obviously, the share of expenditure on other functions depends on the trend of expenditure on the Old age function. Within the share of 'other' functions, no substantial changes in its component parts were observed in the 2008-2010 period, except for unemployment, whose share in total social protection expenditure increased from 1.4% to 2.4%. In the 2010-2016 period, the share of only two components declined: disability (from 13.8% to 10.9%) and survivors (from 10.2% to 9.1%). On the other hand, the share of gross expenditure for the family/children component rose from 7.8% to 8.6%, and that of social exclusion from 1.1% to 1.4%. The shares of the unemployment and housing components remained unchanged.

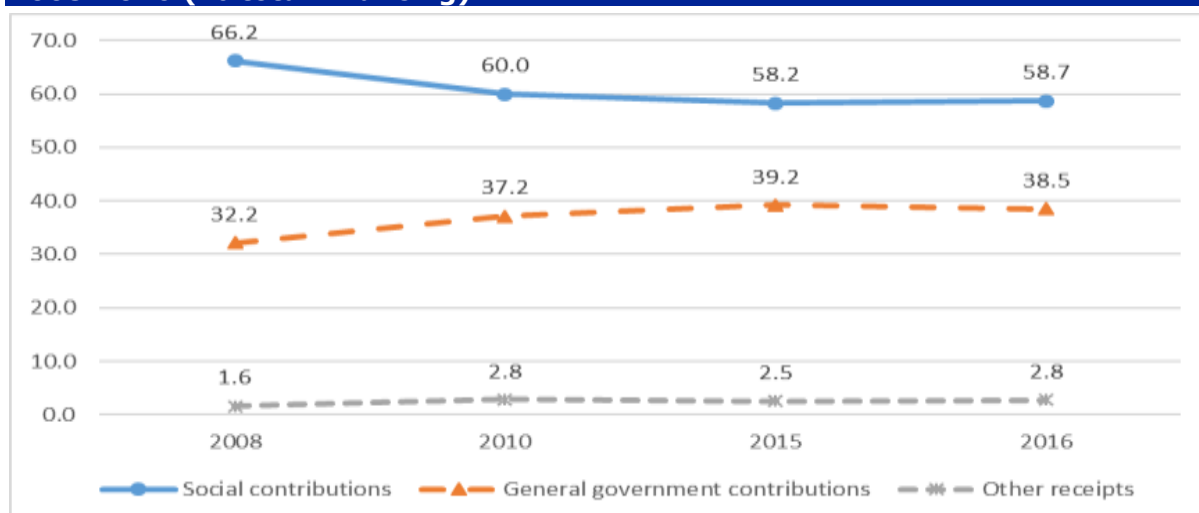
It is evident from the data that a major increase in social protection expenditure as a share of GDP occurred in the 2008-2010 period (see Figure 1). This was mainly due to a decline in GDP. Social protection spending was generally maintained in absolute and real terms, though spending on some smaller programmes (such as social assistance or means-tested benefits) did increase.

Declining economic activity resulted in a fall in the employment rate, from 60% in 2008 to 52.5% in 2013 (Figure A2). After that it slowly recovered, but in 2016 (at 56.9%) it was still below the pre-recession level. The number of the employed in 2010 with respect to 2008 decreased by 81,000 according to the Labour Force Survey (LFS) or even by 123,000 according to administrative sources (Figure A3). This trend continued, so that the number of employed people in 2013 with respect to 2010 decreased by an additional 166,000 according to the LFS, or by 68,000 according to administrative sources. The large fall in employment resulted in substantial reductions in the shares of social contributions paid by employers and employees in total financing of social protection (see Figure 3 in following section).

2 Current mix and past changes in the sources of financing social protection

The social protection system in Croatia has been financed mostly through compulsory social contributions paid by employers/employees and general government contributions. In 2016, 58.7% of overall social protection expenditure was financed from social contributions and 38.5% from general government contributions (other receipts made up the remaining 2.8%) (Figure 3). The structure of social protection receipts has gone through certain changes since 2008: between 2008 and 2016, the share of social contributions fell from 66.2% to 58.7%, while the share of general government contributions rose from 32.2% to 38.5%. To be more specific, the share of social contributions in the total social protection receipts dropped from 66.2% in 2008 to 58.7% in 2016, but the share of general government contributions increased from 32.2% in 2008 to 38.5% in 2016. The share of other receipts rose from 1.6% in 2008 to 2.8% in 2016). The biggest change occurred in the initial period of the economic recession (2008-2010), when the share of social contributions fell from 66.2% to 60.0%. It continued to fall thereafter but significantly more slowly, by a further 1.3 percentage points by 2016.

Figure 3: Division of financing for social protection in Croatia by main source, 2008-2016 (% total financing)



Source: Eurostat, ESSPROS database.

During the 2008-2016 period, the shares of social contributions paid by employers, employees and the self-employed in total social protection receipts all declined. The share paid by employers fell from 30.6% in 2008 to 26.9% in 2016, the share paid by employees fell from 32.2% to 29.2%, and the share paid by the self-employed fell from 3.3% in 2008 to 2.4% in 2016. The share of social contributions paid by benefit recipients was and has remained negligible (0.1% in 2008 and 0.2% in 2016). It seems that the share of social contributions paid by employers and employees decreased in a similar way in 2016 with respect to 2008 (by 12% and 9% respectively), being in line with the total share of social contributions paid by employers (17.2%) and employees (20.0%) (see Table A1 in the Annex). The share of social contributions paid by the self-employed thus decreased by 27%, compared with just 12% for employers and 9% for employees: this could be explained by the fact that the self-employed sector experienced the deepest negative impact during the recession.

The same trend (decreasing share of social contributions, increasing share of general government contributions) can also be found in the main social protection functions: old age and sickness/healthcare. The largest change in the financing of the old age function was observed between 2008 and 2010, when the share of social contributions dropped by 6.1 percentage points (from 66.8% to 60.7%); thereafter it continued to decline, but at a slower pace, reaching 59.1% in 2015. Meanwhile the share of general government

contributions increased between 2008 and 2010 by the same amount (6.1 percentage points, from 32.6% to 38.7%), before falling back to 36.8% in 2015. The share of other receipts was almost the same in 2008 and 2010 (0.7% and 0.6%), but by 2015 it had surged to 4.1%. This growth in other receipts can probably be explained by new regulations in 2015, which resulted in the conversion of disability pensioners to old-age pensioners on reaching the statutory retirement age. In relation to the sickness/healthcare function, the share of social contributions decreased from 87.7% in 2008 to 81.9% in 2015, whereas the share of general government contributions increased from 7.3% to 8.3%; that of other receipts more than doubled between 2008 and 2010 (from 5.0% to 10.7%) before falling slightly to 9.7% in 2015.

2.1 Financing the pension system

Croatian social protection expenditure is largely oriented towards pensions (combining old-age, survivors' and disability pensions). In comparison with other EU member states, because of the war (1991–1995), Croatia has a bigger share of survivors' and disability pensions. In 2007, of the total expenses on pensions, spending on old-age pensions accounted for 60.6%, while survivors' pensions accounted for 19.2% and disability pensions 20.2% (Puljiz, 2008).

During the last 20 years, during which there has been a permanent economic crisis, mostly caused by transition to independence and the war, the number of pensioners has increased, while the number of employed people has dropped (Figure A4). The government responded to the crisis by implementing a policy of mass early retirement. The dependency ratio reached 73.78% in 2000 (support ratio 1.36), 81.36% in 2010 (support ratio 1.23), and 83.56% in 2017 (support ratio 1.20). During the most recent economic crisis almost 200,000 people lost their jobs in Croatia, with poor prospects of recovering employment, whereas the number of pensioners continued to increase.

In the circumstances of population ageing and increasing longevity, the fiscal and political sustainability of the pension system has been a priority for Croatian successive governments. International financial institutions (the International Monetary Fund and the World Bank) have proposed a reduction in public spending, of which pensions constitute a large part, and at the same time entrepreneurs have sought a reduction in labour costs (i.e. smaller social protection contributions and lower taxes). The adequacy of pensions and promises to increase them are an important part of pre-election debates.

Two pension reforms, a 'small' parametric reform of 1998 (which introduced privatisation in the public pension system) and a 'big' reform in 2002 (establishing the three-pillar pension system), laid the foundations for today's pension finance framework.

The 1998 reform increased the statutory retirement age and early retirement age by five years over the period from 1999 to 2008. Since 2003 the pension contribution rate has been 20%. Because of widespread evasion of contributions, finding a more efficient way of collecting contributions was an important part of the reform. Contributions were previously paid to the Croatian Institute for Pension Insurance; but since 2001, as a part of the reform, they have become part of the revenue of central government. That reform made changes in the pension formula and changed the indexation system from wage indexation to combined indexation (50% wage, 50% prices). The purpose of these changes (designed by the World Bank) was to reduce pension spending, in order to cover the transitional costs of introducing second-pillar pensions. The evidence points to a (politically unsustainable) reduction in new pensions of 4-27% between 1999 and 2010. The reform established minimum and maximum pensions, along with a minimum monthly contribution base of 35% of the average salary and a maximum of 600%. Minimum pensions were not means tested, had a very redistributive character and were financed from the budget.

The Croatian public pension system is a defined-benefit scheme based on the point system, primarily financed by contributions of 20% paid by employees out of their gross earnings. Table 1 shows the main characteristics of the financing of the system. Contributions are paid on earnings up to a maximum of six times the average wage. For those insured in

both mandatory pension pillars, contributions in the amount of 15% of gross wages go to the first pillar and 5% goes to the second pillar.

Additional contributions must be paid for the pension insurance of employees in arduous and hazardous occupations listed in special legislation. These contributions are paid by employers at rates ranging from 4.86% to 17.58% of the gross wage. If a person is insured in both pillars, these contributions are also divided between the two pillars: 3/4 goes to the first pillar, 1/4 to the second pillar.

Persons with a non-regular income or so-called 'other income' (fees, authors' fees etc.) pay a contribution (since the recent change) at a reduced rate of 10% instead of the standard 20%. People insured only in the first pillar pay 10% into the first pillar, while two-pillar participants pay 7.5% into the first pillar and 2.5% into the second pillar.

Table 1: Financing of the pension system

	Public employees	Private employees	Self-employed
Contribution base	Gross wage	Gross wage	Gross wage or contribution base (depending on type of activity)
Contribution rate/contribution			
Employer	4.86% to 17.58% for employees in arduous and hazardous occupations	4.86% to 17.58% for employees in arduous and hazardous occupations	-
Employee	20% (public PAYG scheme participants only); 15% (participants in both public PAYG scheme and mandatory fully funded defined contribution scheme)	20% (public PAYG scheme participants only); 15% (participants in both public PAYG scheme and mandatory fully funded defined contribution scheme)	20% (public PAYG scheme participants only); 15% (participants in both public PAYG scheme and mandatory fully funded defined contribution scheme)
State	-	-	-
Other revenues	Government committed to cover deficits	Government committed to cover deficits	Government committed to cover deficits
Maximum contribution	6 times the average wage	6 times the average wage	6 times the average wage
Minimum contribution	0.35 times the average wage	0.35 times the average wage	0.35 to 1.1 times the average wage

The government does not pay specific contributions to the public pension scheme. However, it transfers resources to cover all specific expenditure such as pension expenditure ensuing from special regulations, the costs of the pension supplement (4%-27%) and other extraordinary pension increases, as well as expenditure due to the transitional cost of the pension reform after the introduction of the second-pillar pension. The government is expected to cover any remaining financing gap.

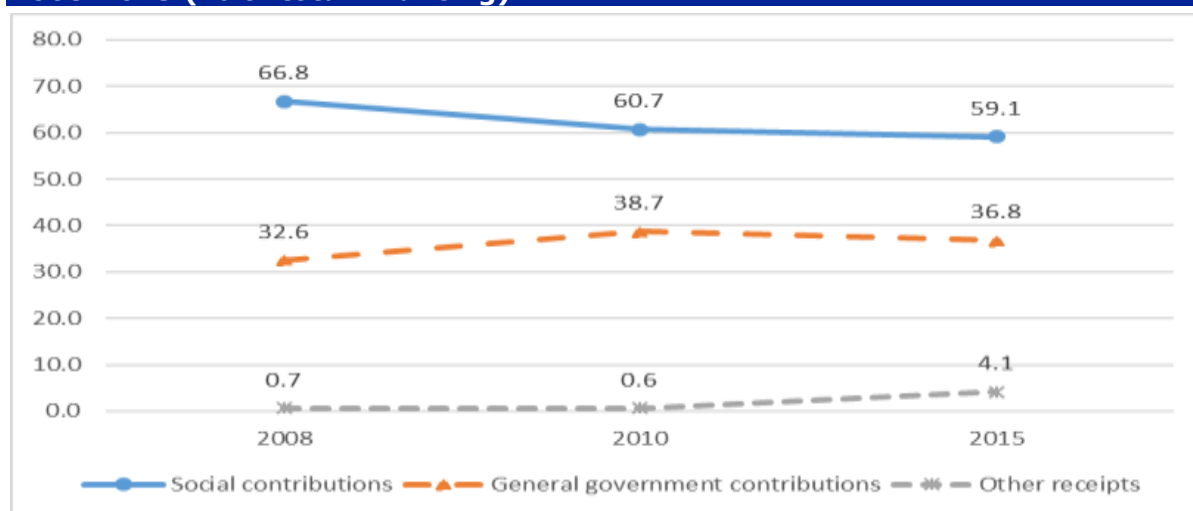
In 2002 the government introduced the three-pillar system. The second pillar was mandatory for persons younger than 40. Those aged between 40 and 50 could choose between staying in the PAYG scheme only or joining the new mandatory second pillar and being in the two-tier mandatory system. Those over 50 remained only in the first pillar. The third pillar, with tax incentives for saving and with rather high premium from the budget, was open to all, regardless of age or employment status.

As stated above, one important objective of the reform was a reduction in public spending on the pension system. Total spending on pensions, as a share of GDP, was 13.87% in 2001, falling to 11.92% in 2005 and 10.3% in 2017. In 2016, contributions covered 54% of pension spending, with the remaining 46% coming from the state budget. Contributions paid into the first pillar in 2013 represented 5.9% of GDP, while 1.6% of GDP went to the second pillar. That year, spending on first-pillar pensions represented 10.9% of GDP.

The old age function represented 31.1% of gross expenditure on social protection in 2008 and 30.8% in 2010. In 2016, it represented 34.2% after a legislative change in 2015 concerning the conversion of disability pensions to old-age pensions once the statutory retirement age was reached.

The main source of financing the old age function is social contributions, with a share of 66.8% in 2008, but because of the impact of the crisis and a falling number of people in employment it fell to 60.7% in 2010 (Figure 4). After that it remained broadly stable, reaching 59.1% in 2015. General government contributions covered 32.6% of total old-age expenditure in 2008, 38.7% in 2010 and 36.8% in 2015. The division of financing of old-age benefits by sub-categories of contributions shows how most contributions for that purpose come from employees.

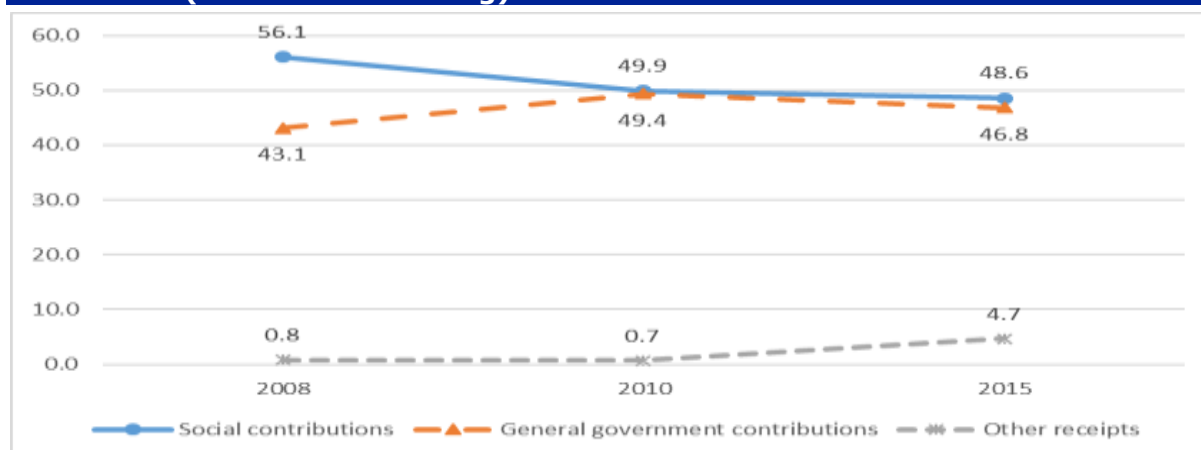
Figure 4: Division of financing of old-age benefits in Croatia by main source, 2008-2015 (% of total financing)



Source: Eurostat, ESSPROS database.

Expenditure on the survivors' function (mainly pensions), as a share of gross expenditure on social protection, was stable over the period 2008-2016 (10.7% in 2008, 10.2% in 2010 and 9.1% in 2016). The main sources of financing for survivors' benefits are (roughly equally) social contributions and government revenue, with a net increase in government spending over the period 2008-2015 (Figure 5). Contributions for survivors' benefits are paid mostly by employees.

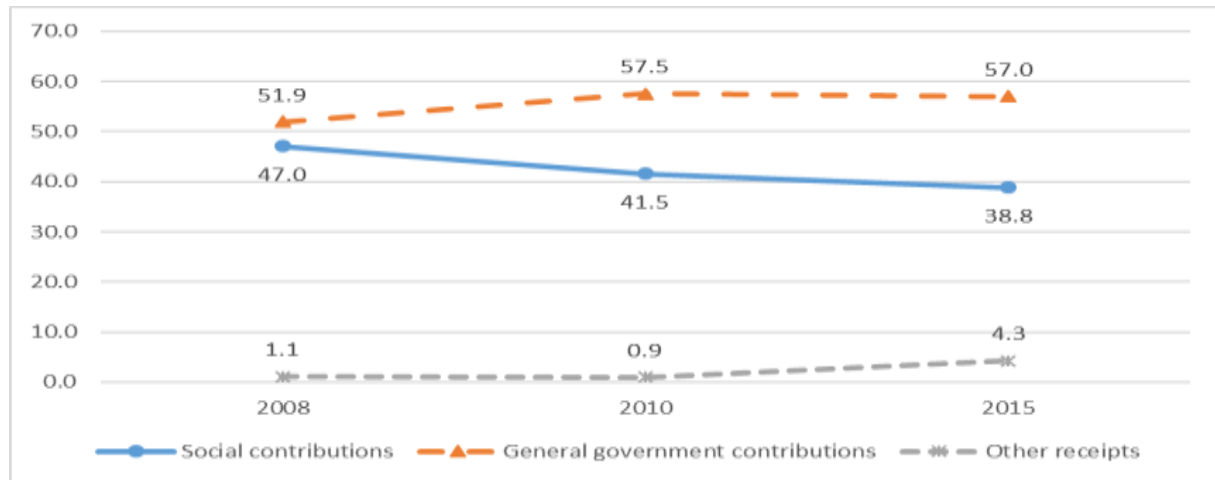
Figure 5: Division of financing of survivors' benefits in Croatia by main source, 2008-2015 (% of total financing)



Source: Eurostat, ESSPROS database.

The disability function accounted for 13.6% of gross expenditure on social protection in 2008 and 13.8% in 2010. Financing has increasingly been the responsibility of the government with a smaller share from social contributions, paid mostly by employees (Figure 6).

Figure 6: Division of financing of disability benefits in Croatia by main source, 2008-2015 (% of total financing)



Source: Eurostat, ESSPROS database.

After the above-mentioned reforms, the government was much more dedicated to the financial sustainability of the pension system – while, on the other hand, requests for an increase in pensions have been constant. Important government measures in this area can be placed in four categories: 1) increases in pensions, including new beneficiaries; 2) reductions in pensions; 3) changes in the classification of pensions; and 4) indexation of pensions.

(1) A politically and socially unacceptable outcome of the parametric reform was that by 2010 pensions for new pensioners were 4% to 27% lower than before the reform. During the campaign before the 2007 elections, the government changed this and provided a supplement to all these new pensioners, as well as providing pensions to Croatian war veterans from Bosnia and Herzegovina. These two decisions caused a new budget deficit.

Coinciding with the global economic crisis, the government also faced the problem that the first pensioners who started retirement from both pillars had pensions that were considerably lower than the pensions of those who retired only in the first pillar of the intergenerational solidarity system. Obviously, that was a badly planned reform, so the government in the autumn of 2011 offered to all voluntary members of the second pillar, in case of retirement, the option to stay only in the first pillar, channelling their savings from the second pillar to the national budget and providing a supplement of 27%. This was the next extension of the budget deficit in pension funding.

Since 2014 the government has introduced two new types of early-retirement pension. First, an early-retirement pension due to long-time insurance for persons aged 60 with 41 qualifying years. Second, an early-retirement pension due to bankruptcy, which was introduced for persons fulfilling early retirement conditions and whose insurance status was terminated due to the employer's bankruptcy, provided they have been unemployed for at least two years continuously prior to retirement.

As part of a further reform in 2018, the government, in order to equalise the rights of all retirees, provided an additional supplement to pensioners receiving pensions from two pillars. For the time being there are only about 300 such persons. Also, the pensions of retirees on minimum pensions (around 246,000 of them) will be increased by 3.13%. As a kind of a demographic measure, the mother of each newly born or adopted child will receive a six-month addition to her contributory period. These recent measures contribute to the

budget deficit. Extended pension rights for war veterans from 2017 and 2018 will also increase the budget deficit

(2) During the economic crisis from 2009 to 2014, Croatia lost 12% of GDP, and the public debt increased from 39% of GDP in 2008 to 84% in 2014. To partly cover the budget deficit, in 2010 the government increased the VAT rate by 1 percentage point (from 22% to 23%) and discontinued the indexation of pensions, introduced a crisis tax for all income above HRK 3,000 (EUR 405) and reduced 'privileged' pensions. Since 2012 the new government has resumed the indexation of pensions, giving this as the reason for increasing VAT to 25% (Bežovan, 2019).

As a temporary measure, in order to reduce the budget deficit, legislation was adopted to reduce special regime pensions by 10%, subject to a floor of HRK 3,500 (EUR 473) per month. A reduction by a further 10% was introduced in 2014 with a floor of HRK 5,000 (EUR 675) per month if certain conditions were met – that is, real GDP growth below 2%, and a state budget deficit above 3% in three consecutive trimesters. The reduction was abolished in 2017 and the previous level of pensions was restored. With the 2018 reform the retirement age was increased and stricter penalties were introduced for early retirement in order to make the pension system more financially sustainable.

Regarding 'privileged' pensions, in 2015 the government calculated, for each of them, the part earned by contributions paid during employment and the part designated as 'privileged'. A new law provided for a different method of indexation to the privileged part, but only if real annual growth in GDP in each of the three previous consecutive quarters was at least 2.0%, and if state budget deficit was under 3%. In 2016 the new government, under pressure from interest groups, abandoned this plan for achieving sustainability of the pension system.

(3) Under the 2002 reform and the introduction of the second pillar, all insured persons with a separate scheme of retirement (e.g. police, military personnel) who were a member of the second pillar when they retired received a pension according to a separate calculation from the first pillar. In 2015 this was a reason for channelling all their savings from the second pillar to the national budget from which they received their pensions.

In 2015 a new regulation converted all disability pensions (without loss of entitlement) to old-age pensions upon reaching the statutory retirement age. According to Vukorepa (2015: 294) '... it creates a totally wrong statistical picture, since old-age pensions are calculated on the actual years of service (contributions paid). Disability pensions are calculated on the years of service plus "additional period", which is a fictive period (not covered with contributions) accredited with the purpose of increasing the disability benefits.'

(4) Pension indexation was carried out twice per year from 1999 to 2013, according to the so-called Swiss formula (50% wage: 50% prices). As mentioned above, in 2010 and 2011, pension indexation was discontinued. Since 2013, the government has continued to apply indexation with a more complex formula. The new indexation formula from 2018 will positively influence pension adequacy.

The increase of 3.13% in the minimum pension in 2018 (as mentioned earlier in this section) can be considered as a measure to help the poor or those who are at risk of poverty.

Since 2014, the old-age pension has been paid in full to beneficiaries who continue in part-time employment after reaching retirement age. Pensions increased during the first part of the Plenković government (October 2016–December 2018) by 6.39%.

2.2 Financing the healthcare system

Contributions for healthcare insurance are determined by a percentage of gross monthly salary paid by the employer or according to the defined insurance base prescribed by special legislation for self-employed persons. The basic contribution for health insurance

was (until recently) 15% plus a 0.5% contribution rate for accidents at work and occupational diseases. Since 2015¹ mandatory health contributions have been paid directly to the Croatian Health Insurance Fund. In addition to the mandatory health contribution paid by employers there is also: (a) a mandatory health contribution rate of 3% on pensions paid by pensioners with a monthly pension over HRK 5,108 (EUR 690); and (b) voluntary supplementary health insurance, available for HRK 70 (EUR 9.30) a month, regardless of age or health status. Rights are comprehensive and healthcare is formally accessible to all, regardless of health or socio-economic status.

Co-payments for visits to doctors, hospital stays and medicines are covered by supplementary health insurance; but children under 18, disabled people, disabled war veterans and family members of deceased war veterans, as well as persons on low income (households with a monthly income below HRK 1,516 [EUR 200]) are exempt from co-payments. Health service costs for the aforementioned groups are financed from general government contributions.

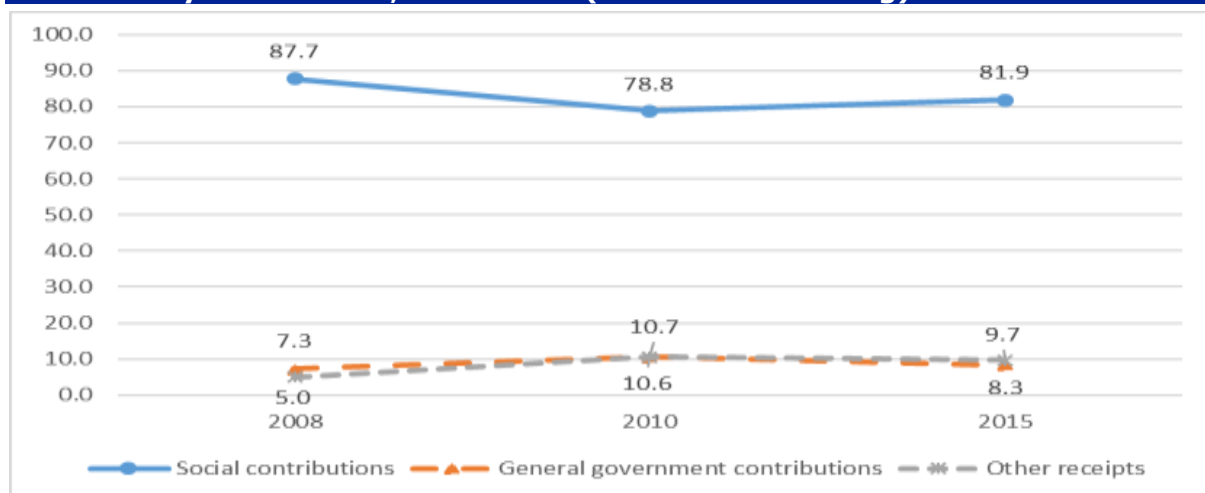
As can be seen from Table A1, social insurance programmes and the relevant contribution rates paid remained almost unchanged during the 2005-2019 period. The only change was a reduction in the health contribution rate from 15% to 13% in the period May 2012-April 2014. The left-centrist government of the day tried to increase economic competitiveness through lowering labour costs for employers but this step produced a further increase in the budget deficit. Because of this, and because the Croatian Health Insurance Fund revenues were part of the state budget at that time, the same minister of finance decided to increase the health contribution rate again to the previous level of 15% from April 2014². On the other hand, the current government decided in 2018 to abolish two small social insurance programmes: mandatory insurance against injury at work and occupational illness (0.5%) and unemployment insurance programme (1.7%) and at the same time to increase the health contribution rate from 15 to 16.5%. In this way, total social contributions decreased from 37.2% to 36.5% starting from January 2019.

ESSPROS data reveal that more than 80% of the total financing for the sickness/healthcare function comes from social contributions (Figure 7). The trend in the financing of the sickness/healthcare function is very similar to the general trend for social protection: over the period 2008-2015, the share of social contributions fell and the share of general government contributions rose (along with the share of other receipts). An explanation for these changes may again be partly found in the severe 2009 recession and the considerable employment decline in 2010. With the more recent improvements in the economy and in employment, the share of social contributions has increased (from 78.8% in 2010 to 81.9% in 2015, and at the same time the share of general government contributions has fallen (from 10.6% to 8.3%). Other reforms within the healthcare sector, such as the 2008 healthcare structural and financing reform, could offer an explanation for the increased share of other receipts, from 5.0% in 2008 to 10.7% in 2010. Research carried out by Broz and Švaljek (2014: 67) showed that the 2008 reform led to an increase in household health expenditure from 2.5% of total household expenditure in 2008 to 3.2% in 2010. This was a result of the reform increasing 'out-of-pocket payments' for healthcare services.

¹ Until 2015 the healthcare contribution was paid to the state budget and then transferred to the Croatian Health Insurance Fund: but since the reform of 1 January 2015, the contributions are paid directly to the Croatian Health Insurance Fund, which functions as an extra-budgetary fund.

² <https://www.vecernji.hr/vijesti/doprinos-zdravstva-vraca-se-na-15-posto-923895>.

Figure 7: Division of financing of healthcare expenditure and sickness benefits in Croatia by main source, 2008-2015 (% of total financing)



Source: Eurostat, ESSPROS database.

Regarding the division of healthcare funding, by far the largest part is paid by employers (84.2% in 2008, falling to 78.1% in 2015). On the other hand, employees do not pay social contributions for healthcare at all, while the share of the self-employed in 2015 stood at the same level (3.5%) as it was in 2008. Financing of healthcare by benefit recipients is almost negligible. The remainder comes from general government revenues (9.7% in 2015).

According to WHO data and research studies by Zrinščak (2019) and Vončina and Rubil (2017), around 80% of healthcare spending in Croatia (public and private combined) is financed from public sources – mostly from healthcare social insurance contributions and to a lesser extent from general government contributions. According to Zrinščak (2019), around 18% of healthcare expenditure in 2014 was financed from private sources; and Vončina and Rubil (2017) used 2015 data to estimate private health expenditure at around 15% of the total health expenditure³ – the average for EU countries. In 2015, Croatia had the fourth-highest share in the EU of total spending on healthcare through voluntary health insurance (8%, compared with the EU average of 4%).

It is a well-known fact that the healthcare sector has continually fallen into financial deficit, with arrears of payments to the pharmaceutical sector in particular. The Croatian government has carried out several reforms aimed at reducing the healthcare deficit and arrears, but without success. In 2019, the Croatian healthcare system accumulated a deficit, according to estimates⁴, of around HRK 7 billion (around EUR 1 billion).

2.3 Financing other functions/schemes of social protection

Unemployment benefits in Croatia before 2019 were financed through a mandatory unemployment insurance programme for all employees with a contribution rate of 1.7%, which was paid on gross salaries by employers. ESSPROS data reveal that there were almost no changes in the 2008-2015 period and that around 95% of unemployment benefits (94% in 2008 and 98% in 2015) were financed from social contributions paid by employers. On the other hand, a major change regarding financing unemployment benefits has occurred as a result of a 'tax reform package' adopted by the Croatian Parliament in December 2018. Under this, the 1.7% contribution rate and insurance base model have

³ http://www.euro.who.int/__data/assets/pdf_file/0009/373581/Can-people-afford-to-payCroatia-WHO-FP-007-2.pdf?ua=1.

⁴ Exact figures are not publicly available.

been abolished, so that from 2019 unemployment benefits in Croatia will be financed solely from general government contributions.

Family/children benefits are mostly financed by general government contributions, the share fluctuating around 84% between 2008 and 2015. Only maternity and maternal leave benefits are financed from healthcare contributions, whose share was stable and fluctuated around 15% (almost all paid by employers [around 14%] and a small element by the self-employed [0.7%]).

The social exclusion function has been predominantly financed by general government contributions, with a share of about 98%. The only change that could be noticed in the 2008-2015 period was a slight fall in the share of general government contributions (from 98.4% to 97.4%) and a slight increase in the share of other receipts (from 1.6% to 2.6%). This change was a result of EU projects and funds, which were used for financing this function after Croatia became a full EU member in 2013.

3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing

Economic trends in Croatia have been positive in recent years and this is expected to continue in the near future. In addition, the Croatian budget was in surplus in 2017, meaning that the general financial framework for financing social protection is currently favourable. Conversely, the ageing of the population and other negative demographic trends (in particular, the emigration of the younger population) could become a serious challenge to the financial sustainability of social protection system in the medium- and long-term perspective.

With the 2018 reform the government is committed to the following goals: a general pension increase, more favourable indexation, an increase in the minimum pension, pension increments for longer employment, and part-time employment for pensioners. With these measures the government is addressing the (difficult to solve) problem of pension adequacy for many retirees. Sustainability is being addressed through an increase in the retirement age, incentives for those working longer, and an increase in penalties for early retirement.

On the other hand, under strong pressure from interest groups, the government has given new rights to Croatian war veterans, including to those from Bosnia and Hercegovina, which will influence the budget deficit. During the pension reform process, despite public pressure, the government was not prepared to tackle the issue of high privileged pensions, which contribute to the budget deficit and reduce social cohesion. The pension system is highly redistributive. The government is not willing to address the issue of contribution evasion, under which many private entrepreneurs officially pay the minimum salary or a smaller salary and pay the rest 'under the table'. Also, part of the population now works without declared contracts. These groups of employees are later eligible for a very redistributive minimum pension. In the future, with such a widespread shadow economy, mandatory pension contributions will be a less reliable source of finance for gross pension spending. Also, the government has missed the opportunity to analyse the transitional cost of the second pillar and to estimate the sustainability of the privatisation of the public pension system.

Trade unions and associations of pensioners, with several small political parties of pensioners, were against the increase in the retirement age, and against increased penalties for early retirement. With a view to enhancing pension adequacy, they proposed more favourable indexation.

The national association of entrepreneurs is very much in favour of the second pillar and advised that the contribution to the second pillar be increased. Recently, several larger companies facing financial difficulties have put forward restructuring plans that include early retirement for the less employable part of the labour force.

On the other hand, the ageing of the population, negative demographic trends with the emigration of the younger population, a low employment rate and weak economic growth are making the pension system financially unsustainable. Public trust in the pension system is deteriorating, the general population does not feel they own the system, and part of the public narrative is that 'in the future there will not be pensions'.

As regards healthcare, some researchers (Vončina and Rubil, 2017) suggest that there is a relatively higher share of voluntary health insurance in Croatia than in other EU countries. However, we believe that the right step would be to increase the premium for supplementary health insurance paid to the Croatian Health Insurance Fund by 20%, with an improved means test (including not only an income test but also an assets test, designed to improve targeting and to better protect poor people). According to the last available data for 2017 published by the Croatian Health Insurance Fund⁵, around 56% of citizens

⁵ http://www.hzzo.hr/wp-content/uploads/2018/04/Izvjesce_o_poslovanju_hzzo_01122017.pdf

(around 2.4 million) are insured through the supplementary health insurance system; 1.65 million paid the premium themselves, and for around 750,000 it was paid for them by the government. The revenue from supplementary health insurance in 2017 was HRK 1.3 billion (less than EUR 200 million).

Other researchers, such as Nestić and Rubil (2014), suggest that there is room to increase private financing in terms of co-payments or the insurance premium in supplementary health insurance (paid to the Croatian Health Insurance Fund) or voluntary private insurance premiums paid to private health insurance companies. They suggest that health financing from private sources in Croatia is lower than in countries with a similar economic development level. However, more reliance on private sources in financing healthcare could produce more inequality in terms of the affordability of healthcare services for lower-income groups. Any change in that direction would need to be accompanied by better targeting (based on income and assets) and caps on co-payments for lower-income groups.

The problem of the financial sustainability of the healthcare sector definitely goes beyond the current and possible future financial mix, and the other side of the coin – the cost-efficiency and effectiveness of the healthcare sector – also needs to be addressed. There are studies, such as Slijepčević (2014) and Vehovec et al. (2014), which suggest that there is significant room for improving the efficiency and effectiveness of the health sector at all levels, and especially at the secondary and tertiary levels and in hospital care and management. There is a widespread opinion that corrupt and semi-corrupt practices in the healthcare sector, especially in public procurement procedures (Budak and Rajh, 2014), increase costs and decrease effectiveness. Thus, even if the financing pressures stemming from the health care sector are not expected to decrease in the future, there is room for improving health care services and standards provided to patients through a better management of the efficiency and effectiveness of the health care sector.

One of the weaknesses of the existing social protection system has been the continuing fall in the share of spending on means-tested benefits, which are mostly concentrated in two functions: social exclusion and family/children. The share of these benefits in total social protection expenditure is two and half times less than the EU28 average. Our proposal is to increase tax expenses for means-tested benefits in these two functions. In this respect, the Ministry of Demography, Family, Youth and Social Policy is preparing a new Social Welfare Act, which would enter into force in 2020, and which it is envisaged would increase the standard rate of the guaranteed minimum benefit⁶ by 50%-62.5% (from HRK 800 [EUR 108] to HRK 1200-1300 [EUR 162-176]) and increase rates for families with children. For the time being, there are no indications as to the increase in the level of child allowances.

Financial support from the central budget is necessary for a balanced development of networks of childcare services at the regional and local levels. The underdevelopment of services is noticeable in particular in the eastern part of Croatia. Here, it is important to emphasise the opportunity of using EU funds in order to improve the availability and affordability of childcare services in underdeveloped regions. In this respect, the Ministry of Demography, Family, Youth and Social Policy announced at the end of 2018 tenders to the value of about HRK 300 million (EUR 45.5 million) from the European Social Fund Operational Programme 'Efficient Human Resources 2014-2020', designed to improve pre-school education services. In addition, the Ministry of Agriculture has decided to allocate more than HRK 860 million (EUR 116 million) available from the European Agriculture Fund for Rural Development to financing the construction and reconstruction of kindergartens in small and rural settlements. About 200 new kindergartens are expected to be built.

⁶ The name of the minimum income scheme in Croatia.

Recommendations are as follows.

Pension system

- The government should make more effort to collect social contributions and to control contribution evasion.
- The government should evaluate the impact of public pension privatisation: it should calculate the transitional costs, analyse the portfolio of shares in mandatory pension funds, and investigate/assess the level of management fees. Sustainability and the negative impact of transitional costs are key issues related to the sustainability of the pension system overall.
- An evaluation of the sustainability and fairness of the third pillar should also be on the government's agenda. The premiums paid to beneficiaries from the budget are not justifiable and sustainable. In fact, the government finances the premiums of well-off citizens from the budget deficit. Instead of that, the government should introduce tax incentives for savers in the third pillar.

Healthcare

- The supplementary health insurance premium paid to the Croatian Health Insurance Fund should be increased by 20%, and the means test should be improved (with an assets test designed to improve targeting and better protect poor people).
- The efficiency and effectiveness of the health sector should be improved, especially in the secondary and tertiary level and in hospital care and management.

Other functions

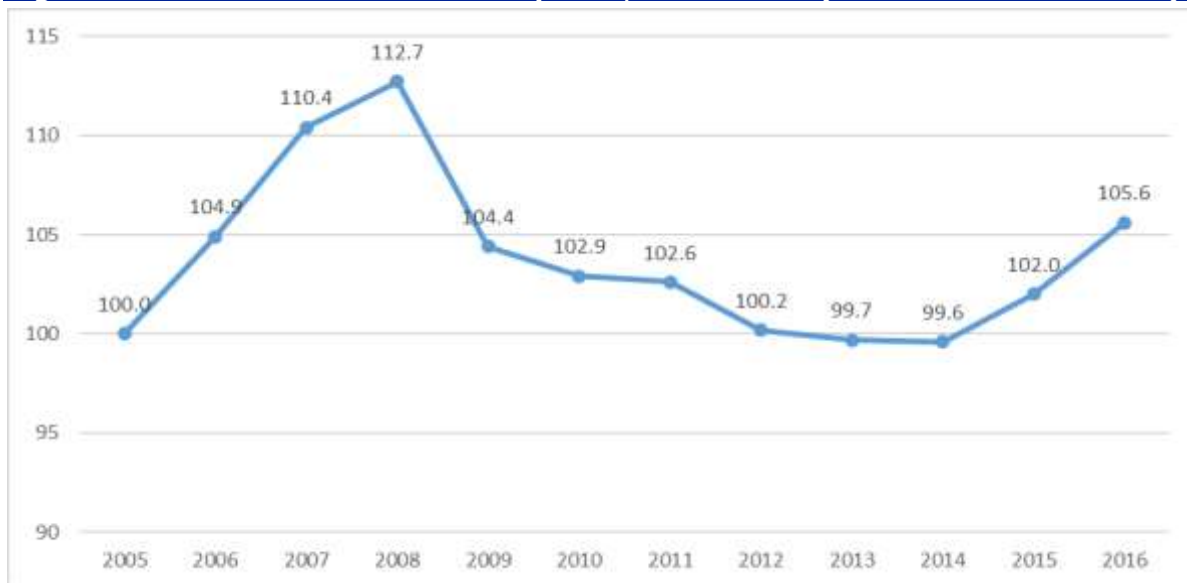
- Government contributions for means-tested benefits in the social exclusion and family/children functions should be increased.
- EU funds should be used to improve the availability and affordability of childcare services in underdeveloped regions.

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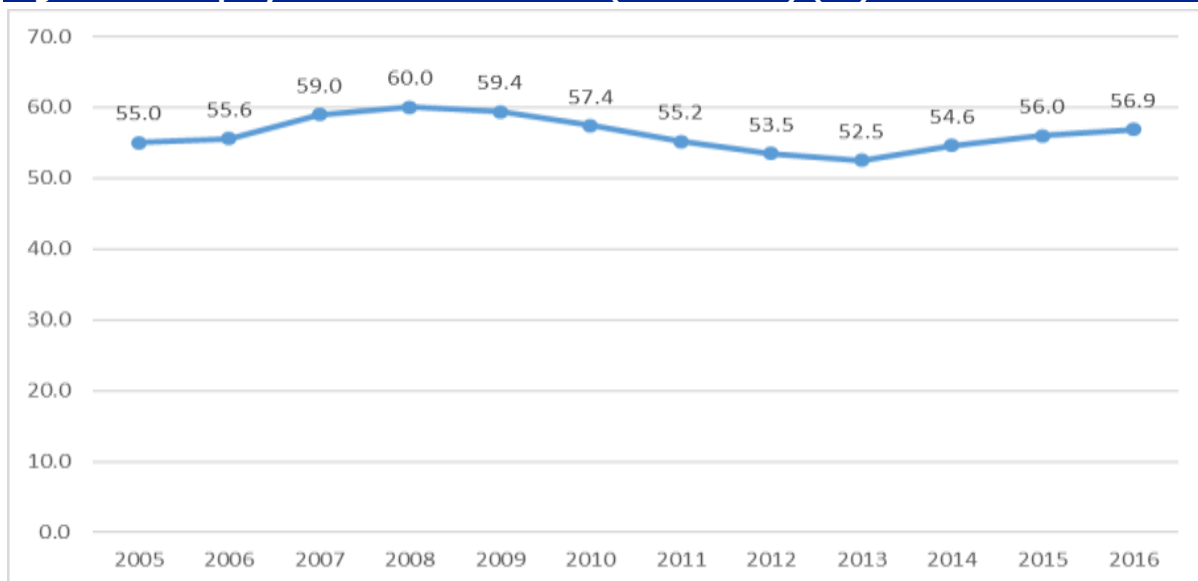
Annex

Figure A1: Croatian GDP at market prices, 2005-2016 (chain index 2005=100)



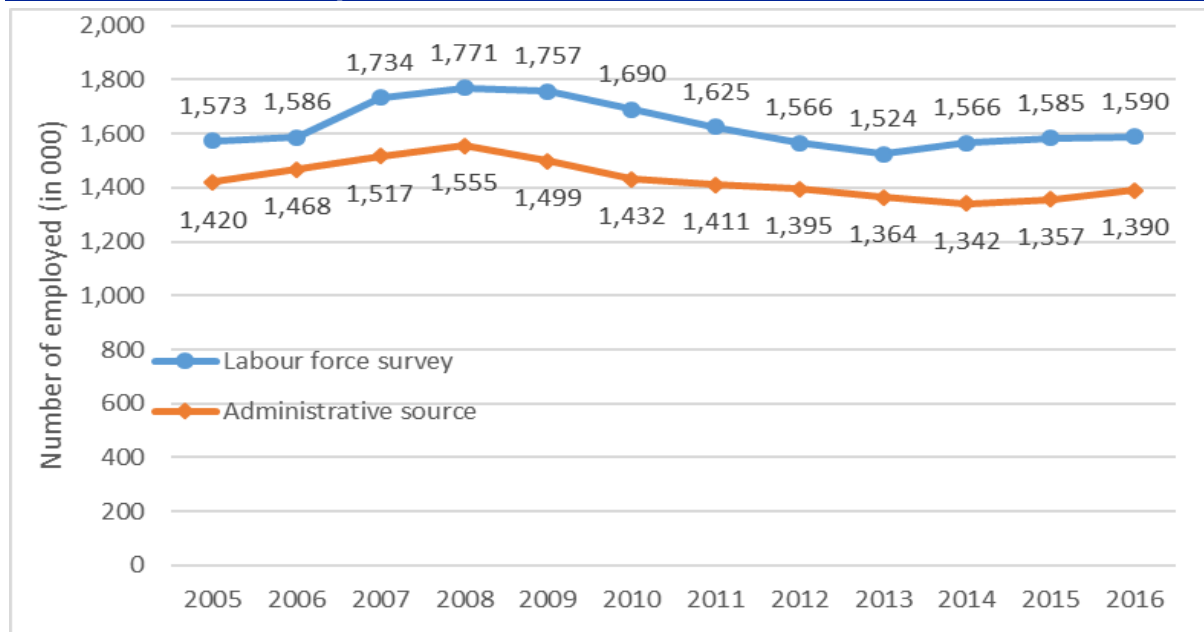
Source: Eurostat (nama_10_gdp).

Figure A2: Employment rates in Croatia (2005-2016) (%)



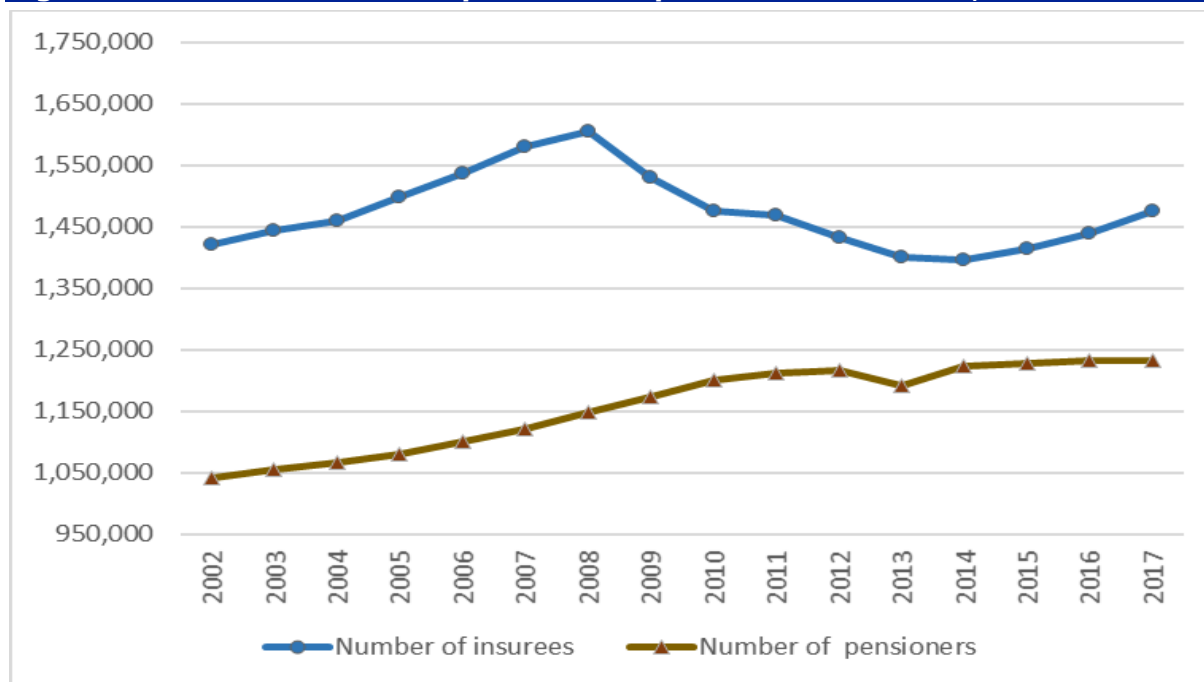
Source: Eurostat (ifsa_ergan).

Figure A3: Number of employed people in Croatia (according to LFS and administrative source), 2005-2016



Source: Državni zavod za statistiku [Croatian Bureau of Statistics] Statistički ljetopis Republike Hrvatske, 2014 i 2017 [Statistical Yearbook of the Republic of Croatia], 2014 and 2017; Priopćenje [First Release], different years. (Available at: <https://www.dzs.hr>.)

Figure A4: Number of insured persons and pensioners in Croatia, 2002-2017



Source: HZMO [Croatian Institute for Pension Insurance].

Table A1: Social insurance types and contribution rates in Croatia from 2005 until 2019

Social insurance schemes	Paid by Employers (2005-2018)	Paid by Employees (2005-2018)	2019
Pension: Inter-generational solidarity (First pillar)		15%	15%
Individual capital savings (Second pillar)		5%	5%
Healthcare	15% (13% from 1 May 2012 till 1 April 2014)		16.5%
Contributions against injury at work and professional illness	0.5% (until 2018)		0
Unemployment	1.7% (until 2018)		0
Total	17.2% (May 2012-April 2014: 15.2%)	20%	Before 2019 37.2% (May 2012-April 2014: 35.2%) In 2019 36.5%

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