European Commission

EUROPEAN SOCIAL POLICY NETWORK (ESPN)

Assessment of pension adequacy

Bosnia and Herzegovina

Nikolina Obradović

Social Europe

EUROPEAN COMMISSION
Directorate-General for Employment, Social Affairs and Inclusion
Directorate C — Social Affairs
Unit C.2 — Modernisation of social protection systems
Contact: Giulia Pagliani
E-mail: Giulia.PAGLIANI@ec.europa.eu

European Commission
B-1049 Brussels

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ESPN Thematic Report: Assessment of Pension Adequacy

Bosnia and Herzegovina

2021

Nikolina Obradović

Directorate-General for Employment, Social Affairs and Inclusion
2020

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Manuscript completed in September 2020.

Luxembourg: Publications Office of the European Union, 2021

Quoting this report: Obradović, Nikolina (2021). ESPN Thematic Report on Assessment of Pension Adequacy – Bosnia and Herzegovina, European Social Policy Network (ESPN), Brussels: European Commission.

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Highlights

- Bosnia and Herzegovina (BiH) has two statutory pension funds organised at the level of the two entities, both functioning on pay-as-you-go and defined-rights principles. Pensions constitute the largest social protection expenditure in the country, amounting to 9.75% of GDP in 2017 (Agency for Statistics of BiH, 27 February 2020). Despite relatively high spending, indicators based on 2015 Household Budget Survey (HBS) consumption data suggest that persons aged 65 and above are more exposed to the risk of poverty than any other age group, while 71.5% are affected by social and material deprivation.
- Despite continued increases in pension funds revenue, a rise in the number of pensioners has been exerting downward pressure on the level of pensions. To avoid a reduction in pension entitlements, the pension funds have often had to resort to borrowing. The transfer of the pension funds to the entity budgets prepared the statutory pension schemes for increased budget financing in the future. At the same time, the entities are taking steps to strengthen the personal (funded) pension schemes, albeit slowly and with uncertain results.
- The population ageing and depopulation caused by emigration and low birth rates, as well as the country's labour market weaknesses (such as the low employment level, the underreporting of wages and the problem of delayed or unpaid contributions), will pose a serious challenge to the functioning of the pension funds in the future. Apart from reforms to tackle these issues, both the pension schemes would benefit from more inclusive and flexible pension insurance rules that would boost the official employment rates of women and those on the margins of the labour market, thereby improving the system's coverage of these groups and securing their income in old age.

1 General description of the national pension system

The country has two entity-based statutory pension insurance schemes that operate through two entity-based pensions funds – the Pension Fund of the Federation of BiH (FBIH PF) and the Pension Fund of Republika Srpska (RS PF). Both entities also have in place legislation for private pension schemes. However, the first personal pension scheme on funded principles was established only in 2017 in the RS.[1] Its coverage and net value[2] are still insignificant, despite income tax exemptions. The RS entity government also subsidises the private pension savings of civil servants.[3]

In both entities, pension insurance is mandatory for all persons in employment (including the self-employed). This provides coverage in old age (old-age pension), as well as in the event of disability caused either at work or elsewhere (disability pension or transfer to a suitable work position) or the death of the insured person (survivor pension), and compensation for physical impairment (if caused by an injury at work or by some work-related illness). In both entities, 65 is the general pensionable age, and a person must have at least 15 years of insurance to be eligible. However, both entity schemes offer exemptions for earlier retirement under certain conditions. In the RS, women may retire at the age of 56, provided they have at least 35 years of insurance; meanwhile, in the FBiH, this is the case for women aged 56.5 and for men aged 61, if they have at least

[1] The RS legislation for a voluntary pension pillar was enacted in 2009 and in the FBiH in 2016.

[2] The voluntary pension fund's current net value is €1,358,851.50 (EPF, 15 April 2020); the voluntary pension fund's webpage does not provide information on the number of insured people.

[3] In accordance with the Decision on Pension Plan of the RS Government (RS Official Gazette no. 64/19), since 1 January 2020 all RS Government employees receive approx. €10 monthly as an incentive to have a private pension plan.

31.5 years and 36.5 years of insurance, respectively.[4] In the RS, both men and women with 40 years of insurance can retire irrespective of age, while in the FBiH such people can retire at the age of 62. Although the pension base in the FBiH is reduced by 0.333333% for every month of early retirement, the effectiveness of this provision is questionable, because the guaranteed minimum pension is set rather high compared to the average wage, thereby rendering the penalties ineffective (at least for low-income earners). In the RS, there are no penalties for early retirement. As a result, the average effective retirement age in both entities is below the pensionable age of 65. However, this indicator is available only for the RS: there, in 2019, the average effective retirement age at which the old-age pension is claimed was 61 for men and 58.5 for women (RS PF, 12 March 2020).

Disability pension can be claimed at any age, but stricter rules apply if the disability was caused outside work than if the disability was caused by a work injury or work-related disease. Disability pension is conditional on medical examination and approval by an authorised commission. Although the general rules for disability pensions set down in legislation appear favourable and have, over the years, remained unchanged, the relative share of disability pensions has been decreasing. The reason for this is that, since 2008, the funds have tightened up on the rules governing the implementation of disability pension provisions. As a result, for most people, it has become harder to secure a disability pension.

Both entity systems function on the pay-as-you-go principle, whereby pensions are financed by the contributions of those in employment. The payment of pension contributions is compulsory for all employees, the self-employed and all income earners. Revenue from contribution payments is the primary source of financing for both pension funds. Yet, both pension funds rely substantially on financing from the relevant entity's government. In the RS, the entity government's financing in 2019 accounted for 19.4% of total revenue (RS PF, 12 March 2020); in the FBiH, in 2018, it covered some 16% (Obradović and Jusić, 2019). In both entities, government financing is stipulated for pension benefits granted to war veterans, and in the RS for all defined benefits granted beyond the rights acquired through the payment of contributions. As both funds are now a part of the entity budgets, the entity governments guarantee pension payments.

The individual pension depends on the length of the insurance and the registered contribution base, i.e. registered gross salary.[5] Both entities apply a points system, whereby the pension base is determined by multiplying the number of personal pension points earned throughout the working life by a value of the point at the time of retirement. The personal pension points are calculated by multiplying the pension points (every year of insurance earns one point) by a personal coefficient (calculated by dividing the total amount of gross salary in a given year by the value of the entity average gross salary[6] for that year). Pensions are exempt from income tax, but in both entities the health insurance of pensioners is financed from the revenue of the pension funds.

Both entity laws have provisions granting privileged benefits for war veterans. These include so-called 'double years' of insurance for years spent in army service during the 1992-1995 conflict (for which contributions were never paid) and other rights granted under general legislation and *lex specialis* legislation. As a result, both entity pension systems have a considerable number of pensioners with war veteran status.

The primary weakness of both pension systems stems from a low level of employment and the generally low level of reported salaries on which contributions are paid. Despite an incremental increase in the level of registered employment in both entities, and a

[4] The FBiH legislation envisages a gradual increase in the eligibility criteria for early retirement and its phasing out by the year 2036 for women and 2026 for men.

[5] In the past, salaries were registered in net amounts.

[6] For years when salaries were registered in net amounts, the total amount of net salaries is divided by the value of the average net salary for that year.

consequent growth in pension fund revenue, this has not been sufficient for any significant improvement in the level of pensions. The soaring number of pensioners has contributed to a very high pension system dependency ratio (98.1% in the RS at the end of 2019, and 79.8% in the FBiH).[7] This means that the number of persons in employment and contributing to the pension schemes is only slightly above the number of pensioners. One reason for such an unfavourable trend is that the BiH 'Baby Boom' generation, born in 1950-1954, has reached the pensionable age of 65. Their retirement was assisted by the generally favourable eligibility criteria of 15 years of paid insurance[8] and early retirement provisions, including the privileged retirement provisions for war veterans.

Self-employed workers and agricultural households should be covered by the statutory pension schemes in both entities. However, their actual registration is traditionally low (ILO, 2009, p. 3). Thanks to legislative changes, the coverage of these categories in the RS has improved somewhat since 2012, contributing to an overall increase in statutory pension system coverage of the employed (RS Government, 2017, p. 4). Furthermore, with changes to the RS Law from 2015,[9] persons insured as self-employed, agricultural households and the clergy may continue to work after retirement. In the FBiH, people working on a temporary contract or doing atypical forms of work do not have to pay the full contribution, but instead only 6%, which is earmarked for the pension fund. However, no benefits can be claimed on the basis of this contribution.

2 Reform trends

The first parametric reforms of the current pension systems were designed and introduced in 2000 by the Office of the High Representative, i.e. the international institution with a special mandate in the country. The reform[10] stabilised the pension funds' finances, but not for long. Very soon, the pension systems came under pressure from the demilitarisation process and the reform of the military, which aimed to provide stable income for war veterans through the pension system. As a result, both entity governments retired a sizeable number of war veterans under privileged conditions. Although the war veteran pensions were supposed to be financed from the entity budgets, that has not been the case in the FBiH (Obradović, 2017; Obradović and Jusić, 2019).

The impetus for reform came from the economic crisis, which became visible at the end of 2008. The entity governments were unable to meet their obligations, while the pension funds were under increased pressure to reduce pension entitlements or to resort to borrowing. Due to discrepancies in implementation of the parametric reforms imposed earlier, the FBiH had urgently to change the general pensions and disability legislation at the end of 2008. The most pressing problem was the disproportionate increase in the level of the minimum pension (compared to the average pension), with the danger that it could be at the same level as the average pension within one year. Hence, the changes to pension legislation tackled only the most pressing issues, i.e. 'freezing' the minimum pension at the existing level and making adjustments related to rulings by the European Court of Justice concerning returnees' rights to pensions. Provisions that stipulated that the FBiH government would finance the privileged war veteran rights were opposed by the government and leading political parties. However, most of those provisions were adopted, because parliamentarians did not fully understand what some of the proposed

[7] The ratio of persons receiving a pension divided by the number of workers contributing to the same scheme in the same period.

[8] The period of 15 years of insurance in FBiH was introduced by the Pensions and Disability Insurance Law in 2018, and in the RS in 2011. Earlier eligibility in both systems was 20 years of insurance payments.

[9] Changes and Additions to the Law on Pensions and Disability Insurance of the RS, RS Official Gazette no. 103/15.

[10] It raised the pensionable age for both women and men to 65, introduced new rules for calculating the pension base that reflect contributions paid throughout the working life, and initiated a mechanism for balancing the funds' expenditure with its revenue, in order to prevent accumulation of deficit.

provisions entailed (Obradović, 2017). At the same time, both entities embarked on reducing the payroll contribution rates. Unlike the FBiH (which reduced the overall payroll contribution rates by 2 percentage points (p.p.) – including a 1 p.p. reduction for pensions and disability insurance), the RS undertook a major reform of payroll contributions, broadening the tax base to include all income and fringe benefits, while reducing payroll contribution rates by 11.4 p.p., to 30.6%. In both entities, these changes became effective from January 2009.

During 2009, with the economic crisis in full swing and with shrinking employment, the reduced contribution rates yielded less revenue. Despite the legal obligation to balance their revenue and expenditure, both pension funds ran a deficit. A reduction in the level of pensions was never considered as a policy option. Furthermore, in the FBiH the entity government was slow to meet its liabilities and to repay earlier accumulated debt, which by the end of 2009 had reached €92.8 million, or 1.2% of FBiH GDP (Obradović, 2017, p. 100). The requisite funding was secured only after the FBIH Pension Fund management took the matter of debt to the courts; the issue was subsequently resolved with an out-of-court settlement and the resignation of the FBiH Pension Fund director. Since then, the FBiH government, in general, has met its obligations towards the pension fund, which are considerable.[11]

The Stand-by Arrangement concluded with the International Monetary Fund (IMF) in June 2009 was aimed at stabilising public finances, and included reform of the pension systems (IMF, 2010). The entities pledged to keep war veteran expenditure under control – including spending on war veteran pensions. The FBiH promised to carry out a review of war veteran beneficiaries and to reform pensions granted to war veterans. In 2010, the RS adopted a Strategy for Reform of the Pension System, which envisaged modifications to the first pillar and the introduction of private funded schemes. As envisaged by the strategy, the current RS Law on Pensions and Disability Insurance was passed in 2011. It introduced the points system for calculating the pension base; the streamlining of benefits according to years of contributions; the indexing of pensions to inflation and wages; and the revision of rights granted to some war veteran beneficiaries. The law reduced the minimum number of years of insurance to 15 (from the earlier 20).[12] Initially, the law did bring some savings (as certain pensions were reduced), but the overall government liabilities increased (Obradović and Jusić, 2019, p.11). Despite increased government funding, even during the first year of its implementation the RS PF ran into deficit, as the employment level that year was at a record low (Obradović and Jusić, 2019, p. 11). In the following years, the contribution revenue gradually increased. Still, it was not sufficient to offset the increase in expenditure caused by a rise in the number of pensioners. Although the budget financing also increased, the RS PF often resorted to borrowing. The solution was to transfer the RS PF to the RS budget, and corresponding changes were made to the RS pensions legislation in 2015. Hence, from January 2016, the RS PF has formed part of the RS entity budget, which means that the RS government guarantees pension payments and covers any shortfall in revenue from contributions.

All unmet commitments related to the Stand-by Agreement were subsequently translated into the Reform Agenda 2015-2018, with the unchanged overall objective of stabilising public finances, including the pension systems. As part of these measures, the FBiH adopted the FBiH Strategy for Pension and Disability Insurance in 2014, with strategic objectives very similar to those of the strategy adopted earlier in the RS. It envisaged the introduction of private funded schemes; and with that aim, the FBiH passed the Law

[11] Though the FBiH Government reduced its obligations to the war veteran pensions by changing Decree I and II in October 2010. It is indicative that one part of the financing for war veteran pensions is still covered by general contributions (for more on this, see Obradović and Jusić, 2019, p.11).

[12] It was required under the Revised European Social Charter that the country ratified in 2008 as well as the earlier ratified ILO Convention No. 102 on Social Security Minimum Standards.

on Voluntary Pension Funds in 2016.[13] Since the RS already had the legislation in place, it pledged to establish a private pension scheme. This was achieved in 2017, with the establishment of the European Pension Fund (EPF),[14] the first private pension fund of its kind in the RS and the entire country.

The FBiH finally passed a new Law on Pension and Disability Insurance in February 2018. This introduced the points system; reduced the minimum years of insurance to 15 (from the earlier 20); provided disincentives for early retirement and incentives for later retirement; and envisaged the transfer of the pension fund to the entity treasury system by January 2020.

With the transfer of the pension funds to the entity budgets, it was implicitly admitted that social contributions would not be sufficient to finance the pension benefits. Moreover, the FBiH has been planning to reform the system of direct taxes to reduce payroll contributions and the tax wedge (Obradović, 2019). This reform, which will have a direct impact on pension fund revenue, has been dragging on for several years, and is now planned under the Reform Agenda 2019-2022. The FBiH has been reluctant to endorse it out of fear that the social insurance funds could lose revenue. However, now that the FBIH PF is integrated into the entity budget, any decline in revenue caused by implementation of this reform should be covered by the budget. On the other hand, once the reform is implemented and the tax wedge is reduced, any increase in a worker's net income will probably encourage personal pension savings. Hence, the reform would contribute to the strengthening of the voluntary pillar. To that end, the RS recently passed Changes and Additions to the Law on Income Tax,[15] envisaging reduction in the income tax base of up to € 615.40 annually to cover savings into a private pension scheme.

3 Assessment of adequacy

3.1 Current adequacy

The available indicators for assessing the pension system adequacy are presented in the Statistical Annex. The most recent living standard indicators are based on the Household Budget Survey (HBS)[16] consumption data[17] from 2015. Also, the Agency for Statistics of BiH uses HBS consumption data for official poverty measurement, where the poverty threshold is defined as 60% of median equivalised[18] household consumption (Agency for Statistics of BiH, 2018a, p. 59). In 2015, the poverty threshold based on consumption was €199.60, resulting in a poverty rate for individuals living in poor households of 16.9% for the country as a whole; meanwhile, the poverty rate for individuals aged 65 and above living in poor households was 19.9%. When the threshold is increased to 70% of median consumption, the poverty rate for individuals aged 65 and above living in poor households rises to 30.8%, indicating that many pensioners have consumption just above the estimated poverty threshold. The relative poverty gap based on consumption for persons aged 65 and above is 25%, which is worth approximately €149.70 in consumption. Agency for Statistics of BiH (2018a, p. 63) points out that the risk of poverty is highly correlated with old age. When disaggregating the poverty estimate by age, the highest poverty rates (of 21.9% and 20.8%, respectively) pertain to single-

[13] FBiH Official Gazette no. 104/2016.

[14] The founding institutions were the European Bank for Reconstruction and Development (EBRD) with 33%, the Pension Reserve Fund of the RS with 33% and the Group plc with 34%.

[15] RS Official Gazette no. 105/2019.

[16] The Household Budget Survey (HBS) is the main reference point in the country for assessing living standards and poverty measurements. It has been conducted sporadically since 2004.

[17] The Agency for Statistics of Bosnia and Herzegovina does not use the income module in the HBS because it is considered to be underreported.

[18] Applying the OECD modified equivalence scale.

person households of persons aged 65 and above, and households where the head of the household is aged 65 or over. The poverty rate for households where the head of the household is a pensioner is 16.3%. Although the poverty rate for pensioners might not appear high, pensioner households make up 35% of all poor households in the country (Agency for Statistics of BiH, 2018a, p. 65). Furthermore, material deprivation[19] among persons aged 65 and above stands at 51.9% (46.4% for men and 55.8% for women), while the rate of material and social deprivation is 71.5% (67.2% for men and 74.6% for women), suggesting that the majority of the population of this age do not have adequate resources for a decent life. In addition, the presence of a gender gap suggests that elderly women are, on average, worse off than elderly men.

Here we should note that the amounts of the minimum and average pensions in both entities in 2015 (monthly average pensions were €198 and €159.60 in the FBiH and the RS, respectively) were below the estimated poverty threshold of €199.60 a month, based on consumption. The RS Ministry of Health and Social Protection (2019, p. 15) notes that pensioners in receipt of the minimum and the average pension can barely cover their basic needs. Pensioners living alone are faced with everyday financial challenges, because the average pension is only adequate to cover utility bills, which leaves them without enough means for food and medicines. This is also suggested by the high housing cost overburden rate of 70.6% for persons aged 65 and above (69.1% for men and 71.6% for women). Furthermore, a self-reported unmet need for medical treatment was reported by 9.2% of women and 6.9% of men aged 65 and above, suggesting that the healthcare services are not accessible to all.

Older people without a pension are in the most difficult position. According to the 2013 Census data, there are substantial numbers of such people (28.5% in BiH as a whole). In some instances, these people may receive means-tested social assistance. But still, the benefit in this case – which varies between €25 and €100 a month, depending on the entity and administrative unit – is below the minimum pension (€190.60 in the FBiH and €100.40 in the RS) and also below the subsistence minimum (Obradović and Dukić, 2016). Nevertheless, we can assume that the pension coverage rate has improved since 2013, as the number of pensioners in both entities has risen.

The consumption quintile share ratio (CS80/S20) for persons aged 65 and above is 4.4 (without any significant differences related to gender), indicating that the consumption of the highest consumption quintile is more than four times greater than the consumption of the lowest consumption quintile. The consumption quintile share ratio (CS80/S20) for the remaining population (0-64) is only slightly (0.37 p.p.) higher than the consumption quintile share ratio (CS80/S20) for persons aged 65 and above. Although consumption inequality is a consequence of income inequality, consumption inequality is generally less pronounced than income inequality. The only available 2015 HBS income-based estimate of quintile share ratio S80/S20 is for the general population, and it stood at 10.4 (Jusić, 2018, p. 17).[20]

Entity pension funds do not have estimates of individual replacement rates. Only the systems' replacement rates (i.e. the proportion of the average pension to the average wage) are available. In both entities, the replacement rates have been kept above 40%: in 2019, the average pension replacement rate stood at 40.60% of the average salary in the RS and at 43.35% of the average salary in the FBiH. If we consider the average replacement rate for the minimum pension (i.e. the minimum pension in relation to the minimum salary), then in the FBiH the replacement rate for the minimum pension is 93.7% of the minimum wage. As explained in the previous section, the minimum pension in the FBiH grew disproportionately rapidly until the end of 2008, when it was 'frozen' at

[19] Material deprivation is calculated based on eight (rather than nine) indicators, because it was not possible to calculate the number of households with a telephone.

[20] Using the same data, Agency for Statistics of BiH (2017, p. 12) estimates the quintile share ratio S80/S20 based on income to be as high as 20.2).

the existing level by legislative changes adopted at the end of the year. In the RS, the replacement rate of the minimum pension is 43.4% of the minimum wage, which is slightly higher than the replacement rate of the average pension. The relative median income ratio and the relative consumption ratio (i.e. comparing persons aged 65 and above with those aged 18-64) are almost the same – 0.88 and 0.87, respectively. However, these fairly high figures indicate a generally low level of income and consumption among the working-age population (18-64), rather than high income and consumption among persons aged 65 and above.

Indicators for the average life expectancy of 65-year-olds and average pension payment duration are available only for the RS entity. In 2019, the old-age pension was, on average, paid to men for 17.4 years and to women for 18.3 years. This is not a significant difference, given that women have a greater life expectancy than men.[21] In the same year, the average age at which men claimed the old-age pension was 61, whereas for women it was 58.5.

The system of long-term care (LTC) in the country is underdeveloped, and its financing relies primarily on families. Under the social protection legislation, families are responsible for providing for their dependent family members, whether these are people with a disability or are old and frail. Government support is provided only if family income falls below the income threshold (which differs according to entity and canton). Pension entitlements are taken into consideration when assessing eligibility for benefits, together with the income of responsible family members. The most commonly used government assistance under the heading of LTC is placement in an institution of social protection. In 2018, only 8.9% of beneficiaries had their stay in an institution covered in full by social services, while 18.7% had their costs covered partially (Agency for Statistics of BiH, 2019, p. 64). The overall number of persons aged 65 and over in an institution is on the increase: in 2014 the figure was 3,308 (0.66% of persons aged 65 and above), whereas in 2018 it reached 5,147 (1.1% of persons aged 65 and above).[22] One of the main reasons for this increase is the unavailability of home-based services. Furthermore, care allowances are provided for different status categories of persons with disabilities. Under the social protection legislation at the entity level, disability benefits are not means tested, so that pension benefits do not preclude access to disability benefits. Exceptions to this are pensioners belonging to the FBiH PF who are entitled to a disability pension, and whose disability was caused by an injury at work or a work-related illness: some of them are entitled to so-called 'compensation for physical impairment', which precludes them from claiming disability benefits under the social protection legislation. Care allowances are means tested when provided under cantonal legislation.

3.2 Future adequacy

A recent IMF (2019, p. 26) paper notes that Bosnia and Herzegovina will face far larger shares of the population reaching retirement age over the next few decades, implying that the pension costs to society will increase in the future. Given the present circumstances and the inadequate level of current pensions, this prognosis raises concerns about future pension adequacy. Both entities have the persistent problem of their pension systems' high dependency ratios. This is due not only to the large increase in the number of pensioners, but (more worryingly) also to the continuing weak labour market trends, i.e. low level of employment, high unemployment and labour market inactivity of the working-age population. If these trends continue, the systems' dependency rates are likely to increase further, which will exert downward pressure on the level of pensions. However, there are political dangers about reducing pension levels,

[21] For the age group 60-64, average life expectancy in 2018 in the RS was 18.89 for men and 22.07 for women (RS Agency for Statistics, 2019, p. 86), while in the FBiH it was 15.59 for men and 17.84 for women (Institute of Statistics of FBiH, 2018).

[22] Estimate based on data from Agency for Statistics of BiH (2019, p. 64) and 2013 Census data.

and the entity governments have thus far avoided it at all costs. If this approach is going to be maintained in the future, budget financing is likely to increase, in order to keep pensions at the existing level, i.e. without reductions. As the pension funds now make up part of the entities' budgets, the financing of pensions should be one of the entity governments' priorities. Hence, if the current legislation remains unchanged, the entity governments will be required to make up any shortfall and to guarantee payments defined by law. However, it is questionable whether the entity budgets will have sufficient capacity to keep the promises defined in pensions legislation. It would entail maintaining pensions at an average system replacement rate of at least 40%.

The first test for the FBiH government will be implementation of the expected reform of direct taxes, which envisages a decrease in pension contribution rates from the currently 23% to 18%.[23] This is, at least in the short run, likely to result in a reduction in revenue from contribution payments. Under the current legislation, the financial gap should be covered by the entity budget. However, if the entity government is faced with budget constraints, the government will have only a few options at its disposal. Although unpopular, the first would be to reduce pensions; the second would be to maintain pensions at the existing level by resorting to borrowing; and the third would be to delay pension payments and accumulate debt towards pensioners. The third option was used in the past, and would be the worst-case scenario for pensioners. Nevertheless, we can expect that budget financing for the pension system will increase. However, it is questionable if the available budget funding will be sufficient to keep the current pension system promises.

3.3 Challenges for future adequacy

For both entity pension systems, the challenges for pension adequacy stem, on the one hand, from a low level of employment (including a low level of female employment) and underreporting of salaries on which contributions are paid, and, on the other hand, from a low effective pensionable age, which contributes to an increase in the number of pensioners. Coverage rates for persons aged 65 and above in both entities have been increasing,[24] but there are still elderly people without a pension – and sometimes without any income.

Although the eligibility criterion of a minimum of 15 years of insurance might appear favourable and achievable by everyone, that is not necessarily the case for the most vulnerable in the labour market. Those are primarily people who work in the private sector, where lack of enforcement of labour and tax legislation means that the line between registered and unregistered work is blurred (Obradović et al., 2019) and labour conditions are often precarious. However, the problem of unpaid contributions is not limited to the private sector: it is also common in insolvent state-owned companies, health centres and institutions that do not have sufficient finances to cover their operational costs, including payment of social contributions. Employees with unpaid contributions cannot claim social benefits (including pension benefit) before the arrears are settled. Furthermore, the FBiH still has not changed the Law on Contribution, by which persons on a temporary contract pay only 10% of social contributions (of which 6% is earmarked as FBiH PF revenue), but have none of the social benefits stemming from these payments.

[23] This would also entail broadening of the tax base. For more on this, see Obradović (2019).

[24] This is an assumption based on a constant increase in the number of pensioners. The only available pension coverage rates of the population aged 65+ are based on 2013 Census data (see Statistical Annex). The coverage rates for recent years could not be calculated because the pension funds could not provide data on the number of pensioners aged 65+.

3.4 Solidarity mechanisms

As already mentioned in Section 3.1, the FBiH system is redistributive towards minimum pensions, while the RS system is ruled more by the equivalence principle. In the RS, the points-system method for determining a beneficiary's pension base stipulates that the beneficiary's personal coefficient cannot be greater than four, whereas in the FBiH it cannot be greater than five.[25] This would suggest that the system in the RS is more redistributive at the expense of high earners (i.e. those whose salaries are more than four times the average salary) than is the system in the FBiH (which 'penalises' those with salaries greater than five times the average salary). Yet, the pensions that are paid also depend on the number of years of insurance and defined benefits for some categories, i.e. minimum pension for residents of FBiH and minimum pension for persons with 40 years of insurance, as well as defined benefits for the different categories of war veterans. In the FBiH, the pensions paid out range from €190.65 to €1,115 a month, whereas in the RS they range from €100.38 to €1,032.30. The minimum pension in the FBiH is paid entirely out of social insurance contributions, requiring more than €10 million monthly[26] to finance the minimum pension gap.[27] This leaves less funding available for the financing of other pension benefits. Entity budget financing plays an important part in both pension systems. Still, in the FBiH it is directed only towards the privileged war veteran pension, whereas in the RS the entity government finances all defined rights (including those of war veterans) over and above the part that has been earned.

In the FBiH, war veteran expenses are only partially covered from the budget, i.e. a substantial amount is covered from contributions, at the expense of pensioners who earned their pensions on the basis of contribution payments. This is clearly pointed out by the Audit Office for the Institutions of the FBiH (2018, p.17), which states that the envisaged financing of war veteran benefits (50% from the FBiH government budget and 50% from the FBiH PF notional sub-account for military contributions) is not sufficient to cover the expenses related to war veteran pensions. The FBiH PF Audit Report for 2017 suggests that some €20,862,978 of war veteran expenses were financed from general contributions that year. Furthermore, it should be noted that implementation of the privileged war veteran provision also means early retirement. These provisions mainly benefit men, since there are very few women with war veteran status.

The entity pension funds do not keep a record of the pension entitlements of men and women. Therefore, it is not possible to estimate gender differences in the level of pension entitlements. However, the available statistics about pension beneficiaries by gender and pension type (see the Statistical Annex) indicate significant gender differences. It is clearly visible from the FBiH data, where we can observe that survivor pensions are enjoyed predominantly by women, while the women's share of other types of pensions is only half that of men. This is a consequence of women's traditionally weak position in the labour market. Besides, the implementation of privileged war veteran provisions in the post-war period has additionally contributed to the gender bias.

Although the pension funds do not keep statistics about the pension entitlements of women and men (or at least they do not make the figures publicly available), there are indications of a gender gap within both pension systems. Namely, the survivor pension amounts to only 70% of the old-age or disability pension (if there are more dependent members, i.e. children, the pension increases by 10 p.p. for each member, up to a maximum 100%). Gender differences are also visible in coverage rates, as presented in the Statistical Annex.

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[25] Whereas the salary contribution base in the entities does not have a ceiling.

[26] Information received from an FBiH PF official on 30 March 2020.

[27] All pensioners receiving the minimum pension have their earned pension below the minimum pension. For instance, a person may have earned pension of €40 (calculated by using the points-system formula), but because of minimum pension provision, the pension actually received will be €190.65. The minimum pension gap (in this individual case amounting to €150.65) is paid out of total social insurance contributions revenue.

Under the general pensions legislation, both pension systems take into account only years of insurance to which pension contributions were paid. In both entities, some workers cannot realise their right to a pension because their employers were not able to meet their social insurance obligations. The Reform Agenda II notes that a third of the total estimated debt towards social insurance funds has been created by companies in public ownership (Common Socioeconomic Reforms for the period 2019 – 2022, p. 4). In the FBiH, pension contributions that remain unpaid by state-owned enterprises and public companies amount to €256.4 million (IMF, 2018, p. 62). In the RS, at the end of 2018 the pension contribution arrears amounted to €236,962,707.70, of which the public sector debt was 39% (RS Government, May 2019, p. 14). This is a persistent problem in both entities. In the past, the FBiH enacted several laws,[28] in some cases authorising the writing off of 50% of tax arrears for companies with at least 50% government ownership, and settling debts through grants by the entity government. However, these favourable rules do not apply to companies in private ownership or their employees. In the RS, the government adopted the so-called Social Programme for Workers, settling the pension contribution debts of employees in former government-owned companies and agricultural cooperatives in the process of privatisation, bankruptcy or closure. Under this scheme, in the period 2004-2019 the RS government enabled the retirement of more than 7,500 workers (RS Government, 3 January 2020). The RS government pays the pension contribution arrears in full, but without interest. In neither entity is aid envisaged for employees of private companies.

4 Recommendations

The future of the pension systems in the country is closely linked to the performance of the labour market. Positive outcomes of labour market reform, including the reform of direct taxation and tax administration, could have a positive impact on pension adequacy. Although the labour force in the country is shrinking, labour force participation rates are still rather low, especially among women. The employment rate of women has increased somewhat (by 4.5 p.p. in the period 2015-2019); but the current rate of female employment is still only 29.9% – 25.3 p.p. lower than the male employment rate. Measures that would raise the participation rates of women and older people could offset the decline in the working-age population. However, the much-needed labour market reforms – such as active labour market measures and investment in day-care services to support labour market participation among women – are costly and have direct implications for government budgets.

The effective pensionable age for both men and women is below the official pensionable age, which is mainly due to early retirement provisions. Bringing the effective pensionable age closer to the official pensionable age would, to some extent, alleviate the pressure caused by a large increase in the number of new pensioners. The entity governments should also consider raising the retirement age (at least for certain professions) and giving some groups of pensioners the opportunity to work and draw a pension simultaneously. That would increase the employment rates of older workers, enabling them to improve their standard of living.

General pensions legislation should be adjusted to accommodate the need for all workers in the labour market to have pension and disability insurance. More flexible pension insurance rules would enable broader coverage of the working population, to include those on the margins of the labour market (i.e. persons doing unregistered work, those doing atypical jobs, part-time work, etc.). In the FBiH, a pension contribution of 6% is currently paid on income earned from temporary, additional and occasional work.

[28] FBiH Law on Debt Collection and Partial Writing-Off of Unpaid Contributions (FBiH Official Gazette no. 26/06); FBiH Law on Financial Consolidation of Mines (FBiH Official Gazette no. 81/08); FBiH Law on Financial Consolidation of Coal Mines (FBiH Official Gazette nos 81/08, 109/12, 05/14); FBiH Law on Financial Consolidation of the public company ‘FBiH Railways’ Sarajevo for period 2008-2012 (FBiH Official Gazette no. 04/09); FBiH Law on Financial Consolidation of Enterprises (FBiH Official Gazette nos 52/14, 36/18, 54/19).

However, no benefits can be claimed on the basis of these payments. The situation must be changed and regulated, so that these contributions are recognised as insurance (it would probably entail increasing the contribution rate).

Further reforms should address the gender pension gap. Apart from labour market measures, this could also be done by recognising women's (and men's) child-rearing obligations, as is the case in some European countries. In the long run, this measure could stimulate a much-needed increase in the birth rate. Furthermore, it would counterbalance war veteran privileges, which benefit mostly men.

Any growth in wages would benefit the pension systems by bringing higher revenue to the pension funds. However, with the current practices of underreporting wages, the tax benefits of any wage increase would be undermined. Hence, the tax authorities should work on increasing tax compliance. The planned reform in the FBiH to reduce payroll contributions and the tax wedge, coupled with heavy penalties for non-compliance and the consistent implementation of tax regulation, would strengthen the pension fund financing.

Compliance with direct tax regulation could be improved if the pension benefits were more visibly linked to contributions paid. This principle has been reaffirmed with the introduction of the points system; but dangers are lurking from provisions related to defined benefits, which, if left unchecked, could undermine the system (as happened in the FBiH PF over the minimum pension).

All the available indicators suggest that there are significant numbers of elderly people with no income, i.e. who are not covered either by pension benefits or social assistance benefits. These people belong to the most vulnerable social group and should be provided with basic income and social services. The link between the pension funds and centres for social work should be established in local communities, in order to reach out to these categories.

The entity governments and the management of the pension funds do not have at their disposal sufficient statistical information to assess the pension funds' financial sustainability, demographic trends, or pension system adequacy. This needs to be changed if pensions policy is to be managed in an anticipatory manner. Statistical information on the pension funds' revenue and expenditure, the number and type of insured persons, pension beneficiaries and levels of pension benefits (all data disaggregated by age and gender) should be published and made available to researchers.

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RS Pension Fund (RS PF), Information received on 12 March 2020.

Statistical Annex

Table A.1 Relative Income

	2015		
	Total	Men	Women
Relative median income ratio, 65+ over 18-64 (2015 HBS data)	0.88	-	-
Relative median consumption ratio, 65+ over 18-64 (2015 HBS data)	0.87	-	-
Consumption quintile share ratio (S80/S20), 65+ (2015 HBS data)	4.42	4.41	4.42
Consumption quintile share ratio (S80/S20), 0-64 (2015 HBS data)	4.80	4.90	4.70
Consumption quintile share ratio (S80/S20) differences (65+-0-64)	-0.37	-0.49	-0.28
Aggregate Replacement Ratio (ARR) %	-	-	-
Pension ratio high / low earner			

Source: Agency for Statistics of BiH, 2015 HBS consumption data.

Table A.2 Poverty and material deprivation (Based on 2015 HBS consumption data)

	2015		
	Total	Men	Women
At risk of poverty, 65+: 60% threshold (%)	19.98%		
At-risk-of-poverty rate, where household head is 65+ (%)	16.3%		
Severe material deprivation*, 65+ (%)	51.89%	46.41%	55.77%
At risk of poverty or social exclusion, 75+ (%)	n/a		
At-risk-of-poverty rate, 75+ (%)	n/a		
Severe material deprivation, 75+ (%)	56.34%	50.89%	59.65%
Relative poverty gap, 65+	25.03%		
At-risk-of-poverty rate, 65+: 50% threshold (%)	11.79%		
At-risk-of-poverty rate, 65+: 70% threshold (%)	30.80%		
Material and social deprivation, age 65+	71.52%	67.22%	74.57%

** Material deprivation is calculated based on 8 (instead of 9) indicators because it was not possible to calculate the number of households with a telephone from the 2015 HBS data.*
Source: Agency for Statistics of BiH, 2015 HBS consumption data

Table A.3 Gender differences

	Year		
Gender gap in pension income (65-79) (%)	n/a	n/a	n/a
Gender gap in non-coverage rate (W-M in p.p.) (65-79)	n/a	n/a	n/a

Table A.4 Housing and health situation

	2015		
	Total	Men	Women
Housing cost overburden rate, 65+ (%)(HBS 2015)	70.56%	69.05%	71.62%
Self-reported unmet need for medical exam 65+ (%) (HBS 2015)	8.22%	6.89%	9.15%
Healthy life years at age 65	n/a	n/a	n/a
Life expectancy at age 65	n/a	n/a	n/a

Source: Agency for Statistics of BiH, 2015 HBS consumption data

Table A.5 Sustainability and context

				2015-2019		
	Total	Men	Women	Total	Men	Women
Employment rate, age group 50-64 (LFS 2015, %)	34.7	45.0	25.1	+ 7.5 p.p.	+10.2 p.p.	+4.8 p.p.
Employment rate, population 65+ (LFS 2015, %)	(4.2)	(5.9)	(3.0)			
Gross public pensions as % of GDP (2017, ESSPROS)	9.75					
Old-age dependency ratio (65+/20-64) (%) (2013 Census data)	22.40	18.7	26.10			
Old-age dependency ratio (65+/15-64) (2013 Census data)	20.20			(2015) + 5.47		
Economic old-age dependency ratio (20-64) (%) (2013 Census data)	0.48	0.73	0.33			
Retirement duration (2018)		(RS) 17.15	(RS) 20.43			
Gross public pensions as % of						

GDP (IMF projections)						
Benefit ratio (%)						
Coverage ratio (% of population aged 65+) (2013 Census data)	(BiH 71.50) (FBiH 75) (RS 66.9)	(BiH 85.3) (FBiH 65) (RS 57.3)	(BiH 61.60) (FBiH 89.2) (RS 80.25)			

Source: Agency for Statistics of BiH and RS Agency for Statistics.

Table A.6 Policy levers

Minimum period for eligibility		15 years
Reference full pension period		40 years
Annual accrual %		1 point for one year of full-time work at average salary)
Reference / target amount		n/a
Reference duration		40 years max.
Notes + voluntary funded pillar		n/a
Credits for child care		None
Credits for unemployment		up to 3 years if contributions were paid by PES
Credits for war veterans		yes
	Federation of BiH	**Republika Srpska**
Indexation	50% increase in inflation and 50% increase of GDP in the previous year	50% increase in the average salary and 50% increase in inflation in the RS for the preceding year
Minimum income	From €25 to €77 monthly, depending on canton	From €66
Minimum pension	€190.65	€100.38

Table A.7 Pension rights beneficiaries by gender and pension type, 2017

Pensioners	Federation of BiH			Republika Srpska		
	Total	Women %	Men %	Total	Women %	Men %
Total number	412,539	50.88	49.12	260,298	n/a	n/a
- Old-age pension	221,390	32.56	67.44	145,374	36.92	63.08
- Disability pension	72,727	33.01	66.99	38,761	28.52	71.48
- Survivor pension	118,422	96.11	3.89	76,163	n/a	n/a

Source: FBiH Institute of Statistics (ESSPROS data); RS Agency for Statistics (2018, p. 513).

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