

Croatia: The important changes in the contribution for pension system

By Predrag Bejakovic

The Croatian Government has announced that it is considering the right to reduce the monthly basis for calculating contributions for pension insurance based on intergenerational solidarity (PAYGO) for salaries up to the prescribed amount. The gross wages and salaries up to EUR 700 are reduced by a fixed amount of EUR 300 euros, so the contribution for PAYGO is paid on EUR to 400. The wages and salaries up to EUR 1,300 euros are reduced by an amount that is calculated separately. The workers would thereby receive higher net wages, the total employers' costs would not increase, and the future pension of such insured persons would be calculated on the previous basis. The government would probably cover the resulting difference with transfers from the central government budget.

It is necessary to praise all efforts to increase the wages of the lowest paid while simultaneously keeping the cost of labour at the same level in order to preserve the cost competitiveness of the Croatian economy, but there is also a need to be aware of the long-term consequences of such a measure. Transfers from the state budget are already significant for the pension system, as the collected contributions are only sufficient for less than three-fifths of total expenditures. Transfers for the pension system have thus become one of the most important causes of the budget deficit of the central government, which accumulates over the years into public debt.

While taxes serve to pay for a public good from which everyone (but no one directly) benefits, the benefit of social contributions is much more immediate, so taxpayers are also interested (or should be) in paying them. The increasing reliance on and importance of contributions, with a simultaneous relative reduction in the tax burden, has meant a reorientation of non-payment avoidance from taxes to social contributions. In the last approximately 20-25 years, the increasing reliance and meaning of the burden of contributions, along with the simultaneous proportional reduction of tax pressure, meant a certain obligation to contribute - the fiscalisation of contributions.

Therefore, no matter how paradoxical it may seem at first glance, to a significant extent it does not matter from where the payment comes from - from the left or from the right pocket - that is, whether the largest part is paid from the budget or from taxes. Finally, the increased payment from the budget is conditionally good because it includes revenues from VAT on imported products.

Despite relatively large allocations for the PAYGO pension system - about 11-12% of GDP, Croatian pensions are small - about 38-39% of the average salary. The maintenance of already small pensions with a reduction in the base for payment of contributions most likely leads to increased borrowing, and then to an increase in other taxes and/or the impossibility of lowering VAT rates.

Furthermore, the calculation costs for the payment of pension contributions almost certainly increase for employers, which are not negligible. At the same time, employees probably will be interested in agreeing with the employer to apply for a lower (or even minimum) wages and salary in order to pay a lower contribution, and receive the rest in some other form - most likely in an envelope wage, which is still a present phenomenon in Croatian economy.