Chapter 3

The Collection of Pension Contributions in Croatia

Predrag Bejaković

Abbreviations

REGOS  Central Registry of Insured Persons
CES    Croatian Employment Service
CHII   Croatian Health Insurance Institute
CPII   Croatian Pension Insurance Institute
IWVs   Invalid war veterans
HAGENA The Agency for Supervision of Pension Funds and Insurance
FINA   Financial Agency for Payment Transaction

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1 The author expresses his gratitude to Ljiljana Marusic of CPII, Marija Zuber of the Croatian Association of Bookkeepers and Financial Experts, Marija Peranic of REGOS, Zoran Anusic of the World Bank Croatia Country Office, and Ivica Urban of the Institute of Public Finance in Zagreb, for their valuable comments. The author is also obliged to the editors, Elaine Fultz and Tine Stanovnik, for their feedback and contributions. Any errors are, however, solely the responsibility of the author.
1. A Brief and Recent History of the Croatian Pension System

1.1. Labour Market Developments, Pension System Parameters, and Sustainability

The 1990s witnessed a major drop in employment in Croatia. The activity rate (labour active/working age population) fell sharply, from 65.3 percent in 1991 to 50.7 percent in 2000. The primary cause was the large-scale exit from the labour force associated with the war and the restructuring of the economy. The number of employed persons declined from 1.43 million in 1991 to 1.26 million in 2000. The cumulative drop in employment, compared to before the transition, amounted to about 35 percent. A small recovery was visible only in the late 1990s.

These changes had predictably negative consequences for the financing of pensions. From 1990 to 2002, the number of insured persons decreased by almost 550,000, while pensioners increased by almost 400,000. This was in part the result of a social policy which afforded pension status to those who had lost their jobs due to war or the economic transition and, in part, due to certain design features of the pension system itself. These features included:

- A relatively low retirement age: 60 for men and 55 for women, with early retirement at 55 for men and 50 for women. Temporary reductions of 1.33 percent were applied per year of earlier retirement.
- The additional option to retire with 40 years of insurance (men) or 35 years of insurance (women) regardless of age.
- A loose definition of disability that provided incentives for some groups of workers to retire early and so to receive relatively high pensions.

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2 Excluding those employed in the police and defence.
3 This applies to legal entities, excluding the army and the police (which is the only definition of employment for which comparable data are available over the entire period).
4 These rules have been in force since 1965 (OG 51/64).
5 These conditions were set in 1983 (OG 26/83).
6 Pension and Disability Insurance Laws 26/83, 5/86, 42/87, 34/89, 57/89 and amendments, OG 40/90.
The combination of these factors placed the system in a tight financial squeeze. In 1990 there was one pensioner for every three contributors, whereas by 2002 the ratio was only 1.36. See Table 1.

<table>
<thead>
<tr>
<th>Year</th>
<th>Insured persons</th>
<th>Pensioners in the public pension system</th>
<th>Ratio</th>
<th>Insured persons in the mixed system</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>1,968</td>
<td>656</td>
<td>3.00</td>
<td>—</td>
</tr>
<tr>
<td>1991</td>
<td>1,839</td>
<td>720</td>
<td>2.56</td>
<td>—</td>
</tr>
<tr>
<td>1992</td>
<td>1,725</td>
<td>775</td>
<td>2.23</td>
<td>—</td>
</tr>
<tr>
<td>1993</td>
<td>1,698</td>
<td>795</td>
<td>2.14</td>
<td>—</td>
</tr>
<tr>
<td>1994</td>
<td>1,621</td>
<td>825</td>
<td>1.97</td>
<td>—</td>
</tr>
<tr>
<td>1995</td>
<td>1,568</td>
<td>865</td>
<td>1.81</td>
<td>—</td>
</tr>
<tr>
<td>1996</td>
<td>1,479</td>
<td>889</td>
<td>1.66</td>
<td>—</td>
</tr>
<tr>
<td>1997</td>
<td>1,469</td>
<td>926</td>
<td>1.59</td>
<td>—</td>
</tr>
<tr>
<td>1998</td>
<td>1,472</td>
<td>955</td>
<td>1.54</td>
<td>—</td>
</tr>
<tr>
<td>1999</td>
<td>1,406</td>
<td>1,018</td>
<td>1.38</td>
<td>—</td>
</tr>
<tr>
<td>2000</td>
<td>1,380</td>
<td>1,019</td>
<td>1.36</td>
<td>—</td>
</tr>
<tr>
<td>2001</td>
<td>1,402</td>
<td>1,032</td>
<td>1.36</td>
<td>—</td>
</tr>
<tr>
<td>2002</td>
<td>1,422</td>
<td>1,042</td>
<td>1.36</td>
<td>929</td>
</tr>
</tbody>
</table>

Source: Croatian Pension Insurance Institute.

During 1990–98 (when a significant reform was enacted), the number of pensioners increased by some 46 percent. This was primarily due to:

• payment of pensions to refugees living in Croatia who had acquired pension rights in other republics of the former Yugoslavia;
• transfer of the financing of pensions for members of the former Yugoslav army from the federal budget to that of the CPII;
• legislation providing eligibility for disability and survivor pensions paid to persons wounded in the war as well as to family members of combatants who had lost their lives; and
• legislation extending pension eligibility to certain former political prisoners.

Until the pension reform of 1998, there were three different bodies administering pension and disability insurance in Croatia:
• the Pension Insurance Institute for Workers (employees);
• the Pension Insurance Institute for the Self-employed (craftsmen); and
• the Pension Insurance Institute for Farmers.

By far, the largest of these three was the Pension Insurance Institute for Workers, with 1.28 million insured persons (87 percent of the total) and 868,000 pensioners (almost 91 percent of the total). The Pension Insurance Institute for the Self-employed is comprised of 80,000 insured persons (around six percent of the total) and 20,000 pensioners (two percent of total pensioners). The Pension Insurance Institute for Farmers had 109,000 insured persons (around eight percent of the total) and 67,000 pensioners (seven percent of total pensioners). During 1994–98, contribution rates for these three schemes were set annually by three specific laws.

The new Law on Pension Insurance (OG 102/98) merged these three institutes to form the Croatian Pension Insurance Institute (CPII). At the same time, it established equal contribution rates for all insured persons.7

The system had, and has, a huge need for subsidies. In 1999, transfers from the central government budget amounted to 33.2 percent of total CPII revenues, or HRK 6.28 billion.8 This was partially due to the need for subsidies for privileged pensions, which were received by 142,574 persons at a cost of HRK 3 billion, or 15 percent of CPII expenditures. See Table 2. In 2000, the transfer increased to HRK 7.16 billion, accounting for 35.4 percent of total CPII revenues, about half of which was needed to subsidise privileged pensions. By April 2003, the numbers of those receiving privileged pensions had risen to 174,259 pensioners, or 16.7 percent of the total.

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7 Until 1998 the term pension and disability insurance was used, and from 1999 the term pension insurance has been applied, although this refers to disability insurance as well.

8 Figures from the Ministry of Finance, 2000.
### Table 2
Number of persons with privileged pension rights in Croatia, 1999 and 2002

<table>
<thead>
<tr>
<th>Category</th>
<th>1999</th>
<th>2002</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Police and judiciary</td>
<td>12,816</td>
<td>13,980</td>
<td>74.6</td>
</tr>
<tr>
<td>Members of WW2 resistance movement (NOR)</td>
<td>73,466</td>
<td>74,668</td>
<td>49.7</td>
</tr>
<tr>
<td>Members of government</td>
<td>126</td>
<td>408</td>
<td>46.6</td>
</tr>
<tr>
<td>Members of Croatian Academy of Sciences and Arts</td>
<td>79</td>
<td>108</td>
<td>97.9</td>
</tr>
<tr>
<td>Croatian defenders from the WW2 Home Guard</td>
<td>34,090</td>
<td>28,705</td>
<td>43.0</td>
</tr>
<tr>
<td>Former political prisoners</td>
<td>5,668</td>
<td>5,772</td>
<td>81.1</td>
</tr>
<tr>
<td>Parliamentary representatives</td>
<td>112</td>
<td>269</td>
<td>206.6</td>
</tr>
<tr>
<td>Members of the former Yugoslav National Army</td>
<td>16,217</td>
<td>14,947</td>
<td>57.5</td>
</tr>
<tr>
<td>Croatian Army</td>
<td>—</td>
<td>6,676</td>
<td>74.3</td>
</tr>
<tr>
<td>Veterans from the Croatian Homeland War</td>
<td>—</td>
<td>29,425</td>
<td>135.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>142,574</strong></td>
<td><strong>174,958</strong></td>
<td>—</td>
</tr>
</tbody>
</table>

**Notes:**
At the end of 2002 the average pension in Croatia amounted to 44.9 percent of the average net wage.

Prior to the disintegration of Yugoslavia, pensions for officers of the Yugoslav army were financed from the Federal government budget. Following the disintegration, the newly formed states assumed responsibility for disbursing pensions for pensioners who were members of the former Yugoslav national army.

**Source:** Croatian Pension Insurance Institute.

By 2001, central government budget transfers to the CPII accounted for 3.4 percent of GDP, the additional deficit that had to be covered amounted 2.4 percent of GDP, and total expenditures for pension and disability insurance amounted to 13.9 percent of GDP.\(^9\) See Table 3. The World Bank identified

\(^9\) The World Bank estimated total transfers at six percent of GDP and total pension spending at 12 percent of GDP for this same year (World Bank, 2001). The discrepancy between these estimates reflects the fact that in Croatia there are still no reliable time series on GDP, so official data is partly estimated.
high pension expenditures as a key cause for the overall high level of public expenditures in Croatia and their continuing expansion (World Bank, 2001).

On June 1, 2000, the pension contribution rate was reduced from 21.5 to 19.5 percent (OG 54/2000). This action reflected a widespread perception of the need to reduce taxes on labour in an environment of high and rising unemployment.\(^{10}\) However, no modelling had been done on the likely impact on CPII revenues. The impact was negative and immediate. In nominal terms, CPII contribution revenue fell in June 2000 (as compared to May) by around five percent, and did not reach nominal May 2000 levels until June 2001. There was an understanding that the central government budget would cover the shortfall resulting from the cut (Anusic, O’Keefe, Madzarevic-Sujster, 2003).

### Table 3
Revenues and expenditures of the Croatian Pension Insurance Institute (as percentage of GDP), 1996–2002

<table>
<thead>
<tr>
<th>Year</th>
<th>Total revenues</th>
<th>Contributions</th>
<th>Other</th>
<th>Transfers</th>
<th>Total expenditures</th>
<th>Deficit/ surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>11.5</td>
<td>10.1</td>
<td>0.3</td>
<td>1.1</td>
<td>11.4</td>
<td>0.1</td>
</tr>
<tr>
<td>1997</td>
<td>12.1</td>
<td>9.9</td>
<td>0.3</td>
<td>2.1</td>
<td>12.5</td>
<td>–0.3</td>
</tr>
<tr>
<td>1998</td>
<td>11.7</td>
<td>8.5</td>
<td>0.4</td>
<td>2.8</td>
<td>12.0</td>
<td>–0.3</td>
</tr>
<tr>
<td>1999</td>
<td>13.4</td>
<td>8.8</td>
<td>0.2</td>
<td>4.4</td>
<td>13.4</td>
<td>0.0</td>
</tr>
<tr>
<td>2000</td>
<td>13.2</td>
<td>8.4</td>
<td>0.1</td>
<td>4.7</td>
<td>13.3</td>
<td>0.0</td>
</tr>
<tr>
<td>2001*</td>
<td>11.5</td>
<td>8.0</td>
<td>0.1</td>
<td>3.4</td>
<td>13.9</td>
<td>–2.4</td>
</tr>
<tr>
<td>2002*</td>
<td>8.0</td>
<td>7.1</td>
<td>0.1</td>
<td>0.8</td>
<td>13.2</td>
<td>–5.2</td>
</tr>
</tbody>
</table>


* Since July 2001, pension contributions and payments have been included in the central budget.

\(^{10}\) According to the Croatian Employment Service, registered unemployment rose from 14.5 percent in 1995 to 22.8 percent at the end of 2001.
An important accounting change occurred in July 2001, when pension contributions and payments were directly included into the central government budget and no longer appeared on the CPII balance sheet. The widening gap between expenditures and revenues, which was previously covered through explicit transfers from the central government budget, now became an inherent state responsibility.

Another revenue shortfall appeared in the public pension system in 2002. This resulted from the partial privatisation of the Croatian pension system and the diversion of a portion of contributions to privately managed individual savings accounts. Enrolment in these second pillar funds began in late 2001, and by mid-2002 a large number of insured persons had opted for the mixed system. A quarter of the contributions made on their behalf was diverted to the second pillar, leaving a corresponding increase in the public pension financing deficit.

1.2. Pension Reforms

As indicated above, the first reform of the pension system took place in 1998, when Parliament enacted the Law on Pension Insurance (Zakon o mirovinskom osiguranju – OG 102/98). Known as the “small pension reform,” this law aimed to reduce the annual pension deficit. It increased the retirement age gradually (by six months per year) for men to age 65 and for women to age 60 by 2008. It also gradually expanded the years of work counted in the pension formula, from the best consecutive ten years to the entire working period (also by 2008). It was hoped that this would provide an incentive for workers to pay contributions, or at least reduce incentives to evade them, since doing so would decrease the amount of the future pension. The minimum age for early retirement was also increased from 50 to 55 for women and from 55 to

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11 Some 37 percent of those who could choose opted for the second pillar; this was below government expectations.
60 for men. Early retirement pensions were permanently reduced by 0.34 percent for every month that a person retired before the statutory retirement age, which represents an increase in comparison to the previous penalty. The definition of disability was tightened, and the procedure for the determination of disability modified, resulting in a reduction in the rate of approval of new applications for disability pensions. See Table 4.

<table>
<thead>
<tr>
<th>Year</th>
<th>Old age pensioners</th>
<th>Disability pensioners</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>34,498</td>
<td>9,541</td>
<td>44,039</td>
</tr>
<tr>
<td>1994</td>
<td>22,156</td>
<td>12,022</td>
<td>34,178</td>
</tr>
<tr>
<td>1995</td>
<td>28,980</td>
<td>16,154</td>
<td>45,134</td>
</tr>
<tr>
<td>1996</td>
<td>20,359</td>
<td>9,667</td>
<td>30,026</td>
</tr>
<tr>
<td>1997</td>
<td>21,271</td>
<td>7,041</td>
<td>28,312</td>
</tr>
<tr>
<td>1998</td>
<td>30,614</td>
<td>14,234</td>
<td>44,848</td>
</tr>
<tr>
<td>1999</td>
<td>31,671</td>
<td>37,112*</td>
<td>68,783</td>
</tr>
<tr>
<td>2000</td>
<td>28,624</td>
<td>2,675</td>
<td>31,299</td>
</tr>
<tr>
<td>2001</td>
<td>25,091</td>
<td>3,406</td>
<td>28,497</td>
</tr>
</tbody>
</table>

* The one-time increase in 1999 was caused mainly by a provision of the Law on Pension Insurance (OG 102/98) that made certain invalidity insurance rights (such as allowances for part-time work and reassignment) part of the disability pension system. The holders of these rights thus became disability pension recipients.

Source: Croatian Pension Insurance Institute.

12 In general, an early retirement pension can be taken within five years before the required age for a full old age pension. In 2003, the age threshold for early retirement was 57.5 with 35 years of employment for men; and 52.5 with 30 years of employment for women. By 2008, the age threshold will increase to age 60 with 35 years of employment for men, and 55 with 30 years of employment for women.
In 1995, the Croatian Government began to work on another reform with the help of the World Bank. This involved partial privatisation of the system. This second pension reform, called “the great reform,” was adopted in two acts: the Mandatory and Voluntary Pension Funds Act (OG 49/99) and Act on Pension Insurance Companies and Benefit Payment Based on Individual Fully-Funded Retirement Savings (OG, 106/99). The reformed pension system has three pillars:

- a mandatory pay-as-you-go public pension system;
- a mandatory individual capitalised savings system. All those under age 40 at the time of the reform had to participate. Those between ages 40 and 50 could opt either to remain in the pay-as-you-go system or to divert part of their contributions to one of a number of competing individual savings funds. By law, these funds must invest at least 50 percent of their assets in conservative government securities issued by the Republic of Croatia or the Croatian National Bank. In addition, no more than 15 percent of pension fund assets may be invested outside the Republic of Croatia. All contributions are exempt from taxation, and the pension is subject to a personal tax allowance; and
- a voluntary savings system based on capitalisation for those who want even more insurance against the risks of old age, disability, and death. The insurance operates according to the same principles as the second pillar with one exception – the insured person decides on the amount of

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13 According to the Articles 68–79 of the Mandatory and Voluntary Pension Funds Act.

14 Such regulation does not preclude investments in equities: five percent of a fund’s assets may be invested in short-term bank deposits and other short-term securities, and up to 30 percent may be invested in equities on organised capital markets.

15 In 2003 personal tax allowance (exemption) for pensioners was HRK 2,550 per month. On the amount of pension between HRK 2,550 and HRK 3,500 per month, tax is paid at the rate of 15 percent; on the next HRK 3,750 (from over HRK 3,000 and up to HRK 6,750 per month), at the rate of 25 percent; on the next HRK 14,250 (from over HRK 6,750 and up to HRK 21,000 per month), at the rate of 35 percent; and over HRK 21,000 per month, at the rate of 45 percent.
the contribution s/he makes. In addition to private pension companies, these third pillar funds may be established by trade unions and employers. The state provides an annual subsidy of up to HRK 1,250, and allows a deduction of up to HRK 1,050 per month from personal taxable income. This means that there is a double benefit – state subsidy and tax deduction – for these contributions.

Proponents of the reform cite the following positive features:
- The management of worker savings by one type of fund (pension management fund) and the payment of benefits by another (pension insurance companies) should diversify and reduce the risks for the whole system.
- Funds on the account are owned by the insured person, and not by the fund or another entity. It was hoped that this would increase workers’ willingness to pay contributions.
- Funds on the account are protected from court enforcement, bankruptcy or liquidation, as well as use before retirement by their owner.
- Insured persons have a free choice of their pension management fund, as well as the possibility of transferring the account into another fund, which should increase the competitiveness and quality of funds’ operations.
- The account is portable, and the funds remain under the ownership of the individual, regardless of changes in employment, until retirement.
- Insured persons are informed about the transmittal of their contributions by their employers, which might lead them to press for their employers’ compliance with the contribution requirement.

Current pensioners and older insured persons remain entirely in the first pillar. The pension contribution rate was increased to 20 percent. For some categories of insured persons (younger than 40 at the time of the reform, and those between age 40 and 50 who opted for the mixed system) the contribution rate for the first pillar is 15 percent of the gross wage, while five percent is diverted to the second pillar.

Between November 15, 2001, when people started enrolling in the mandatory pension funds, and December 31, 2002, the end of the open season,
nearly one million (928,709) insured persons became members of the mandatory individual savings funds. Insured persons who were younger than age 40 and who failed to select a fund within the legally prescribed period (three months from the beginning of compulsory pension insurance) were assigned by REGOS in accordance with a prescribed algorithm. The first such assignment took place in early April 2002. In 2003, REGOS continued to assign insured persons who had not chosen a fund within three months of the inception of their employment.\footnote{In January 2003, 9,725 insured persons who exceeded the period of three months from their new employment as at December 31, 2002 were allocated. In February 2003, 8,791 insured persons whose last chance to select a fund personally was the last day of January were allocated.}

For 2002, the cumulative amount of collected gross contributions for the second pillar was HRK 1.94 billion and administrative fees were HRK 14.3 million, so net contribution was HRK 1.9 billion (HAGENA, Monthly Report for January 2003). At the end of September 2003, there were 1,035,210 insured persons in the second pillar.

2. An Overview of the Current Contribution Collection System

2.1. The Institutional Setting and the Contribution Collection Mechanism

2.1.1. The Situation Prior to Reform

Until mid-2001, Croatia had separate systems for collection of social insurance contributions and personal income taxes. Contributions were collected by the CPII and Croatian Health Insurance Institute (CHII), while personal income taxes were collected by the Tax Administration. According to the World Bank (2002), this produced a number of problems:
• a heavy reporting burden on employers, who had to submit information on contributions and taxes to different institutions, all of which had their own reporting format. In all, employers were required to submit some 20 different forms on either a monthly or annual basis;
• a further burden on firms resulting from dual systems for control and enforcement of the contribution requirement, with multiple separate inspections and verifications;
• administrative inefficiency, caused by parallel networks of staff engaged in collecting revenues and processing data in the CHII, CPII, and the Tax Administration. These institutions dealt with the same set of employers. For example, in the CPII alone, in 2003 the estimated number of staff dedicated to these functions is around 1,000 (out of a total 3,300);
• a lack of accountability and transparency in the system, as each institution negotiated specific payment arrangements with employers and failed to share contributor data with other institutions;
• a lack of coordination in developing, implementing, and evaluating strategies to increase compliance; and
• a heavy demand on public audit functions, which were already overstretched.

2.1.2. The New Arrangements

The partial privatisation of the Croatian pension system created a need for new procedures for collecting, processing, and transmitting contributions. Changes were necessary to ensure transmittal of contributions to the new individual savings funds and to provide detailed monthly accounting of the amounts so transferred. The funds also require government regulation to protect workers’ interests. These needs are being met by two new institutions, as described earlier: REGOS (Srednji registar osiguranika, or Central Registry of Insured Persons) and HAGENA (Agencija za nadzor mirovinskih fondova i osiguranja, or the Agency for Supervision of Pension Funds and Insurance), as well as by a redefinition of the roles of CPII and the Tax Office. The new division of responsibilities is as follows:
REGOS

When REGOS was first established in 1999, its mandate related exclusively to the new second pillar: it was to establish and maintain a system of individual accounts for members of the new mandatory savings system.\(^{17}\) However, with the passage of two additional laws in 2001 and 2002, its functions were extended considerably to include the collection of data on all social insurance contributions, personal income tax, and surtax.\(^{18}\) These laws redesigned REGOS to unite the functions of several different state institutions. Its responsibilities under this expanded mandate are to:

- register insured persons with the second pillar individual savings funds (since the beginning of 2002);
- collect second pillar contributions, control them by checking them against the associated employer reports (R–S forms), and allocate them to the appropriate second pillar funds;
- maintain a central database of all individual accounts, employers, and pension funds;
- provide information to mandatory fund members and authorised institutions;
- report to the mandatory funds on the structure of their membership and provide them with relevant data from employer reports (R-S forms);\(^{19}\)
- collect and process data on each insured person, including data on wages, mandatory social insurance contributions, personal income tax, and surtax; and

\(^{17}\) This authority is provided by the Mandatory and Voluntary Pension Funds Act (OG 49/99, 63/00 and 103/03 – PFA in further text) and the Decree on Establishing the Central Registry of Insured Persons (REGOS) (OG 101/99).

\(^{18}\) These were the special Law on Collection of Data on Insured Persons, Mandatory Contributions, Personal Income Tax and Surtax (Zakonom o prikupljanju podataka o osiguranicima, o obveznim doprinosima, porezu na dohodak i prirezu, OG 114/01 and 153/02).

\(^{19}\) The R–S form is “Insured person specification on calculated and paid mandatory contributions, personal income tax and surtax” (Specifikacija po osiguranicima o obračunatim i uplacenim obveznim doprinosima, porezu na dohodak i prirezu poreza na dohodak).
control other mandatory payments, including contributions for the first pillar, health insurance contributions, unemployment contributions, and personal income tax and surtax.\textsuperscript{20}

The first five of these responsibilities are related to the original mandate of REGOS, and the last two, to the expansions in 2001 and 2002.

REGOS data are also supposed to be used by other institutions for control of payments, as well as for determining worker eligibility for pensions, health insurance, and unemployment benefit. However, this data sharing does not yet work well, particularly with the Tax Administration and CHII. See Section 2.1.4.

It is important to note that REGOS does not perform on-site inspections, as this is the responsibility of the Tax Administration.

REGOS is financed from the state budget and not from contribution revenues.

\textit{The Tax Administration}

Since July 2001, the Tax Administration, an entity of the Ministry of Finance, has been responsible for the control of collections for all mandatory social insurance contributions (health insurance contributions, unemployment insurance contributions, and first pillar pension contributions).\textsuperscript{21} Since January 2003, it has also been responsible for on-site control of second pillar contributions.\textsuperscript{22} See Section 2.1.4. As explained previously, it is supposed to receive and use REGOS data for this purpose.

However, this arrangement is not yet in place. The main reason is overlapping legal statutes and discrepant interpretations of the law by the two agencies. While the law requires that other government agencies make use of REGOS data, the Tax Authority's authorising legislation also calls for it to collect data through its own forms. So, the Tax Authority continues to collect

\begin{itemize}
\item Through its IT system, REGOS controls calculation of contributions as stated on the R–S form.
\item Article 3 of the Law on the Tax Administration (\textit{Zakon o poreznoj upravi} – OG 67/01).
\item Law on Mandatory Contributions, as previously cited.
\end{itemize}
its own data, offering the explanation that the R–S form cannot completely substitute for its own since there are inherent differences in the two data sets. Namely, tax data refers to incomes that are actually paid in a particular year no matter when they are legally earned, while social insurance data covers incomes that were legally earned in a particular year no matter when actually paid.

The Tax Authority is responsible for enforcing the contribution requirement for all social insurance benefits, a responsibility that, unlike the control function, is clearly exclusive.

The Croatian Pension Insurance Institute (CPII)

Under the new arrangements, CPII ceded its responsibilities for collection of contributions to the Tax Administration and REGOS. However, legislation states that the CPII should continue to control contributions and other relevant data related to pension rights. CPII will perform these functions for some time, particularly for individual wage histories of those workers who are missing records for some years.

CPII also continues to maintain records of insured persons for the first pillar, though under the new arrangements its main data provider will be REGOS (data from the R–S form). Actually, the CPII record-keeping function is even expanded, as it is now using pension registration data (the M-1, M-2 and M-3 forms) as well as data from REGOS (the R–S form) to create its own annual records of insured persons.

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23 Specifically, CPII is assigned “control of accuracy and calculation of contributions,” as well as the ex post control of wages declared and contributions paid.

24 The CPII should fill in this data at the latest during the process of computation of pension entitlements.

25 The M-1P form is a form for registering into insurance; if the employee changes employer, the employer must submit the M-2P form, i.e. registering out of insurance. The M-3P form contains data that refer to changes that occurred during the insurance period – such as new surname, education degree, etc. All these forms are provided by the employer.

26 This is similar to the M-4P form, which contained annual individualised data on insured persons provided to the CPII by employers. The M-4P was abolished as of January 2004.
The CPII’s official budget has been trimmed along with its responsibilities. Since January 2004, its budget includes only agency administrative costs, whereas in 2002 and 2003 it still included some pension expenditures, such as pensions paid abroad.

The CPII remains a “first pillar institution.” As before, it is governed by a 13 member tripartite board, appointed by the government.

**HAGENA**

HAGENA is responsible for the monitoring and regulation of pension funds. Its basic task is to protect the interests of pension fund members and participants in voluntary pension insurance. It issues and revokes licences for pension funds, monitors their operations and that of REGOS, and enforces the laws governing the second pillar.

### 2.1.3. Registration

Employers are obliged to register each new employee with the CPII within 15 days of the commencement of employment. They do so on form M-1P, Insurance Application (*Prijava na osiguranje*), which requires basic information: the name of employee and employer, type of work, identification numbers, education and qualification level, working time, etc.

This same 15-day time limit also applies to employee registration with REGOS for the second pillar. See Figure 1. Significantly, under this procedure, there is no need for the employer to know the employee’s choice of a particular pension fund, but only whether s/he is participating in the second pillar. This feature of the registration system avoids the employer’s interference in the employee’s decision.

Currently in Croatia there is no unified registry of insured persons. This means that the employer must submit separate registration forms for pension insurance (CPII) and health insurance (CHII). The self-employed are required to present certain attestations in order to register: either proof of registration in the business registry or, for farmers, documents proving that they are owners, tenants, or lessees of farmland or forestry.
2.1.4. Payment and Control of Contributions

The payment and control of contributions involves a number of agents and institutions whose roles are described below.

An employer pays contributions on behalf of employees from the employer’s bank account to a Tax Administration account within the State Treasury, except for second pillar contributions, which it pays to a special REGOS transfer account (*prolazni racun*) in the Treasury.

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27 The actual payment of contributions from employers is still mostly done by the Financial Agency (FINA), the successor agency of the central payments system. The agency serves as an outsourcing agent for the banks. Formerly this agency was ZAP (*Zavod za platni promet*), the central payment agency. Because of its strong IT support, many banks decided to outsource the function of financial transactions to FINA. However, with the development of IT at the banks, the role of FINA will probably diminish in the future.

28 There is a separate subaccount for each type of contribution, except the second pillar contributions, which go to a REGOS account. This is a transitory account with the central bank. REGOS actually also has an account within the state treasury, but it is used only for its operating costs, and these are covered by the central government budget. In other words, second pillar contributions do not mix with operating expenses of REGOS. The employer’s bank is obliged by law to inform the Tax Administration if the employer paid wages but failed to pay related contributions, no later than eight days after the wages were paid. However, this requirement is not being enforced.
At the same time, the employer is obliged to complete the R–S form. The R–S form includes individualised monthly data on:
• calculated pension contributions for the first and second pillars,
• health insurance contributions,
• unemployment contributions, and
• personal income tax and surtax.29

Thus, the R–S form contains information on all compulsory contributions and direct taxes, which is a completely new way of collecting these data.

The employer sends the R–S form only to REGOS.30 It is envisioned that this form will become the employer’s sole report to government, and REGOS will then share this information with other agencies. Thus, the new system should reduce the administration costs to businesses through reducing the number of forms that employers have to complete in paying contributions and wages, and unifying them under one R–S form (World Bank, 2003).31 While this unified reporting promises great simplification, it has not yet been achieved. Under current procedures, employers are also required to send monthly reports to the Tax Administration – the ID and IDD forms.32 This

29 Persons liable for personal income tax and who have a domicile or a common residence in the area of the commune/municipality that has prescribed the surtax on income tax are also liable for surtax. The surtax base is the amount of income tax. Rates are determined according the following rule: a commune at the rate of up to 10 percent, a city with a population below 30,000 at a rate of up to 12 percent, a city with a population over 30,000 at a rate of up to 15 percent, and the city of Zagreb at a rate of up to 30 percent.

30 The R–S form is supposed to be submitted each time contributions are paid. If in one month a wage is paid in two or three instalments, the R-S form should be submitted each time.

31 It is envisioned that data exchange procedures between institutions will be developed according to contracts that will be, according to the legislation, signed between these institutions.

32 ID and IDD forms contain cumulative monthly data on contributions due and paid contributions and taxes. These are submitted by persons who are legally obliged to perform calculation and payment (employers and payers without established labour relation). The forms ID and IDD are sent once a month and do not contain individualised data on insured persons.
The duplicative procedure is obsolete, and in the future the Tax Administration will have to find ways to rely on the R–S form instead of obtaining its own separate information.

Once REGOS receives the R–S form, it matches actual contributions paid for the second pillar to the contribution amounts reported on the form. For first pillar contributions, the REGOS procedures are less comprehensive: applying IT procedures, it simply checks the internal consistency of the information on the R–S form, ensuring that the contributions which are reported correspond to the level of reported wages and the applicable contribution base and rate. It does not check these reported amounts against actual contributions paid. REGOS performs similarly limited control procedures for health insurance contributions, unemployment insurance contributions, and income tax data. Thus, except for the second pillar, REGOS only collects data and checks its internal consistency. It does not perform the entire IT data processing necessary for full control.

After REGOS completes these procedures, it transfers the second pillar contributions to the different private savings funds according to fund membership data. See Figure 2. Contributions for the first pillar are not transferred to a CPII account but rather remain in the State Treasury account for direct disbursement of pensions. The money flow from the State Treasury to the CPII, indicated in Figure 2, refers to the monies provided for CPII administrative costs and other CPII operations.

The shift of responsibility to the Tax Authority took place in several steps:
- In July 2000, the Tax Authority – through the single Treasury account – was given authority for the collection and control of pension contributions for all workers except the self-employed. CPII remained directly responsible for this group, because the Tax Authority did not yet have the necessary IT procedures in place.
- In July 2001, the Tax Authority was given responsibility for contribution collection for the CHII.

33 The R–S form contains data on contribution base (wages, etc.) and calculated first pillar contributions on the individual (page B of R–S) and employer level (page A of R–S).
34 The CPII provides the Treasury with data on pension payments to be made.
Figure 2
Flow of money and information

MINISTRY OF LABOUR AND SOCIAL WELFARE

HAGENA

CPII for 1st pillar
Mandatory pension funds
Voluntary pension funds

Flow of money
Flow of information
Control

REGOS

Bank

State Treasury

Employer

Insured employee

R–S form

ID, IDD

CONTROL TAX ADMINISTRATION
• Effective 2002, the Tax Authority became responsible for all auditing of enterprises (on-site control), with support by the CPII for control functions on employer reporting of employee status.
• In mid-2002, the Tax Administration assumed responsibility for unified control and enforcement of all social insurance contributions, including those of the self-employed.

The Tax Administration is also responsible for enforcement actions to collect all (including second pillar) contribution payments.

The new unified system of collections is expected to improve resource utilisation. Some preliminary information from the World Bank suggests that, during its first nine months of operation, compliance improved. (However, some officials of the CPII call this into question, asserting that the methodology for measuring compliance has changed.) The direct state responsibility for covering the CPII deficit has also helped to rationalise cash management, as there is no longer a need for the CPII to take out short-term loans from commercial banks. Furthermore, the CPII has been freed to concentrate on its basic task, i.e. the administration of public pension benefits.

2.1.5. IT System, Information Exchange, and Duplication

The CPII maintains three main databases: insured persons, pensioners, and contribution payers. Its operations have been only partially computerised, and there are important functions which continue to lack the required level of IT support. The most important individual records kept by the CPII are still based on annual reporting by the employer.35

Since REGOS collects individualised data on a monthly basis, it is possible for CPII, as well as other agencies, to develop more up-to-date records. Moreover, these agencies have a legal obligation to reorganise their procedures

35 The employer reports on the M-4PP form and on the form, “Recapitulation of paid salaries, wage compensations and contributions for pension insurance” (Rekapitulacija isplacenih placa, naknada i doprinosa za mirovinsko osiguranje).
and forms to make use of data collected by REGOS instead of requiring employers to duplicate, on a yearly basis, data previously submitted monthly on the R–S form.\textsuperscript{36} However, this reorganisation has not yet been achieved; and in the meantime employers are making serious complaints about overlapping data requirements. They point out that virtually the same data must be provided to the REGOS on the R-S form, to the Tax Administration on forms ID and IDD, to FINA on form SPL, to the CPII on forms M-4P, M8P, etc. These duplicative requirements increase businesses’ compliance costs, which estimates show are high in Croatia.\textsuperscript{37} The situation is projected to improve in 2004, when several forms are to be cancelled.\textsuperscript{38}

REGOS uses its data to send an “Annual Report for Fund Members” to all persons participating in mandatory individual savings schemes under the second pillar. The report contains information on the transactions that occurred in the member’s individual account during the previous calendar year, as well as the member’s account balance on December 31. Members can check this data, as well as the up-to-date status of their individual accounts, via the “Individual Account” application on the REGOS Web page. They may also request an up-to-date statement at REGOS counters.

REGOS data is confidential, and governmental regulations pose restrictions on who may access and use it and under what conditions. Pursuant to these regulations, REGOS has taken measures to ensure the security of its data and to protect the privacy of workers and employers. It uses special algorithms to encrypt documents, including secure hash marks issued by the US National Institute of Standards and Technology.

\textsuperscript{36} It is envisioned that in the beginning REGOS will share this monthly data through transfers, later by direct access to host databases.

\textsuperscript{37} See Zuber (2003a) and Blazic (2004).

\textsuperscript{38} These are the M-4PP (M-8P) form containing annual individual data on working periods and salaries, the M-5P (M9P) containing data on insurance periods and compensations of salaries after the cessation of employment relation paid by CHII, the M-6P (M-1P0P) form containing data on insurance period, compensation of salary and contribution base in relation to professional rehabilitation and disability pension due to professional incapacity to work, and the M-1P6P (M-1P7) form containing data on compensations of salaries paid by centres for social work and welfare.
REGOS has also made efforts to use technology to facilitate communication with the public. All the required programmes for preparing the R–S form can be downloaded from the REGOS Web site. At the beginning of 2003, it opened a call centre to provide fast and accurate replies to the questions of citizens and insured persons. The call centre receives on average 250 calls per day. Most questions are answered immediately, while the more complex ones are referred to affiliated institutions.

2.1.6. REGOS and the Second Pillar

As described previously, REGOS maintains an accounting system for second pillar individual savings accounts. Its records show that, in 2002, the total amount of contributions to the second pillar was HRK 1.97 billion. From this, HRK 1.938 billion was allocated to the personal accounts of fund members by December 31, 2002. This means that 98.4 percent of contributions paid to the second pillar were allocated. The remaining 1.6 percent could not be matched with data on the R–S form. This might be, for example, because the payment document (key for connecting the data with the payments) included an incorrect reference number, because the contributions were made on behalf of newly-employed persons who had not yet selected a fund, or because the individual on whose behalf the contributions were made was not eligible to have a second pillar account.

After all the controls are applied, if data are not reconciled in a three-day period, contributions are transferred from the regular REGOS account to a temporary second pillar contributions account. At the same time, R–S records are transferred to a special database that contains unmatched data. This temporary account is under the responsibility of the Ministry of Finance, but REGOS administers the data and performs the necessary procedures.

REGOS makes efforts to match data in the temporary account and R–S data on a daily basis. When data are reconciled and matched, contributions are credited to the appropriate individual accounts and transferred to the second pillar fund. Also on a daily basis, REGOS makes electronic transmissions of both individualised and consolidated data to the funds; and it transfers related contributions to the fund accounts. In cases where R–S data are
correct but contributions are less than they should be, contributions are proportionally allocated to the second pillar accounts. For example, if 70 percent of all contributions are paid, 70 percent of contributions due to the individual accounts are allocated. R–S records are simultaneously updated with this information, and an “unresolved” status code is assigned until all due contributions are paid. When missing contributions related to that particular R-S form come in, contributions are credited to the second pillar account and transferred to the fund.\textsuperscript{39}

REGOS also receives the requests of insured persons who are applying for or want to change their mandatory individual savings fund. In the future, when insured persons will retire and wish to convert their individual savings to a monthly annuity, REGOS will transfer the balance in their fund to a pension insurance company selected by the individual.

2.2. Who is Covered by Mandatory Pension Insurance?

Pension coverage in Croatia is very broad: it applies to all employees, self-employed persons, and farmers.\textsuperscript{40} In addition it extends to:

\begin{itemize}
\item members of management boards, unless they are insured on another basis;\textsuperscript{41}
\item priests, monks, nuns and other clerical officers, during their service in a religious community, unless they are insured on another basis;\textsuperscript{42}
\end{itemize}

\textsuperscript{39} Each contribution bill contains matching data that connects it with the particular R–S form record – employer ID number, wage bill year and month, and bill sequence number.

\textsuperscript{40} According to the Law on Pension Insurance (OG 102/98), Article 12, farmers and members of their households who perform agricultural activities as their only or principal occupation must be mandatorily insured. Persons are not deemed to perform agricultural activities as their only or principal occupation if they are mandatorily insured on another basis, or if they receive pensions, or if they are enrolled in regular educational institutions.

\textsuperscript{41} Article 13 of the Law on Pension Insurance (OG 102/98) stipulates that members of management boards of trading companies must be insured mandatorily.

\textsuperscript{42} Article 14 of the Law on Pension Insurance (OG 102/98).
parents who stay home to care for a child during its first year of life, provided that the parent is not insured on another basis.\footnote{Where both parents perform such parental duties and they are not insured on another basis, the mother of the child will be insured unless the parents decide otherwise, according to Article 15 of the Law on Pension Insurance (OG 102/98).}

The law also provides an option for voluntary insurance for persons whose mandatory pension insurance has terminated. They may insure themselves under the so-called “prolonged insurance scheme” within 12 months of termination. This option applies to persons who are:

- on unpaid leave;
- caring for a child under age three;
- receiving vocational training following the termination of the employment contract or cessation of self-employment;
- unemployed and registered with the Croatian Employment Service; and
- sailors after cessation of a temporary employment contract.

### 2.3. Method of Paying Contributions

The law provides that it is employees alone who must pay pension contributions for both the first and second pillars, without a matching contribution from their employers. However, withholding, reporting, and transmission of contributions are the employer’s obligation.\footnote{Article 40 of the Compulsory and Voluntary Pension Funds Act.} For some particular forms of employment (arduous and unhealthy jobs, police and military service, etc.), or where the employee has a particularly serious illness (multiple sclerosis, blindness, etc.), insurance periods are counted in so-called “extended duration”: that is, 12 months of insurance are counted as longer periods (from 14 to 18 months).\footnote{Article 17 of the Law on Pension Insurance (OG 102/98). Pension insurance with extended duration (\textit{Osiguranja s povećanim trajanjem}) according to the appropriate Law (OG 71/99) is provided for some particular forms of employment (arduous and unhealthy jobs, police and military service, etc.), or where the employee has a particularly serious illness (multiple sclerosis, blindness, etc.); insurance periods are counted in extended duration.} In these cases, besides the regular contributions paid by employees,
employers must also pay special contributions to both pillars (as with regular contributions, a quarter goes to the second pillar).

The employer calculates all mandatory social contributions and pays them in one amount for all employees, at the same time that wages are paid. The employer simultaneously prepares the R–S form. An employer with more than 20 employees must prepare and deliver this in electronic form, while small employers may deliver it on paper. As explained previously, this form contains individualised data on wages, contributions (both first and second pillar), and taxes, as well as a summary total. (Health and unemployment insurance contributions are not individualised because all these contributions are the employer’s obligation and are calculated as a certain percentage of the wage bill for all the employees. However, the health and unemployment systems may require individualised data in the future.)

The R–S form has two parts. The first part (page A) contains data at the employer level that identify that particular R–S and serves to connect the R–S form with the related contribution payment bill. It also provides the total amount of wages, health insurance contributions, and the first and second pillar contributions. The second part (page B) contains individualised data on each employee, including the second pillar contribution data.

Page A data must match the data on page B, and these values must also match the actual amount of contribution payments. As explained earlier, it is the job of the Tax Authority to perform on-site control of contributions to ensure that these values match. For purposes of control, REGOS should provide the Tax Authority with data from the R–S form. If values do not match, an error code should be flagged, and the employer should prepare a new form or to correct data in the previously submitted document (data file).

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46 Since 2002, payment clearing activities may be performed by commercial banks. However, most of them concluded contracts with FINA for outsourcing this function. Thus, the majority of payment clearing activities is still performed by FINA.

47 By the end of 2003, the first pillar data should have been consolidated. This means that the data will be compressed on a yearly basis according to the rules legislated for the first pillar. For example, instead of 12 or more records that contain data on each wage and contribution payment, wages will be summarised at the year/employer/employee
However, these procedures are not yet in place. As explained previously, the Tax Authority refuses to use REGOS data and still collects its own on its own forms. As a result, the objectives of the 2003 law are not yet fulfilled.48

3. The Contribution Base and Rates for Different Groups of Contributors

3.1. Overview

Contribution bases and rates have changed frequently in Croatia over the years. Therefore, the situation must be examined from year to year; the period of analysis here will be from 1995 to 2003.

Since the beginning of 1995, the base for paying contributions has been linked to, and determined in accordance with, definitions in tax law. Thus, salary is defined as all forms of remuneration paid by an employer to an employee that are subject to personal income tax. This definition is still in effect.

Beginning in 1996, employers that failed to pay salaries for the previous month (by the 15th day of the current month) nevertheless had to pay pension contributions on the minimum contribution base.49 Such contributions were deemed as an “advance payment,” i.e. a portion of the contributions that would become due in full when salaries were finally paid. This rule applied until the beginning of 2003, when it was repealed.50 Since then, the employer level. These processes will be automated and will include a comparison between actual contribution payment data and the R–S form.

48 Furthermore, in June 2004 the Tax Authority proposed that REGOS’ role should be limited to the second pillar and that it (the TA) would instead collect information on wages, contributions, income tax, and surtax on its own forms, process this data, and supply it to the CPII, CHII and other agencies. The issue is unresolved, leaving considerable uncertainty for the future of the collections system.

49 Prior to 1996, this base applied only to health insurance contributions.

50 The cancellation was done in the Book of Rules on Mandatory Insurance Contributions and the Order on the Mandatory Insurance Contribution Base (OG 158/02).
has been obliged to pay the full amount of contributions due on time; and so-called “advance payments” (which in fact allowed a deferral of the remaining contributions due) are not permitted.

There has been no minimum wage in Croatia since January 1, 1996. For purposes of calculating pension contributions, a minimum base is set each year in an order by the Minister of Finance. It amounts to 35 percent of the average monthly gross salary for full-time work in the preceding year, as published by the Croatian Bureau of Statistics. A long list of separate bases also apply for various groups of self-employed and farmers. There is a ceiling

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51 The monthly minimum contribution base for all insurance (health, pension) was as follows (in gross amounts): 1995 – HRK 906 monthly (applied and relevant only for health insurance); 1996 – HRK 1,100; 1997 – HRK 1,210; 1998 – HRK 1,370; 1999 – HRK 1,500; 2000 and 2001 – HRK 1,700; from April 1, 2002 – HRK 1,800 HRK; and for 2003, HRK 1,850.50 (OG 158/02).

52 The bases for 2003 were: HRK 1,858.50 for prolonged pension insurance of permanent seasonal workers and volunteers; HRK 3,451.50 for insurance of craftsmen whose income is established on the basis of business accounts; HRK 5,841 for insurance of self-employed persons whose income is established on the basis of business accounts; HRK 2,920.50 for insurance of craftsmen and persons practicing independent professions, in the case when income tax is paid in a lump sum; HRK 5,841 for insurance of craftsmen, persons practising liberal professions and activities in agriculture and forestry, when their income is subject to profit tax and no entrepreneur’s salaries are paid. Namely, they pay profit tax instead of PIT and do not receive entrepreneur’s salaries; HRK 2,124 for insurance of farmers, when their income is not subject to income tax, or when income tax is paid lump sum, and for insurance of clergy; HRK 2,655 for insurance of farmers whose income is established on the basis of business accounts; HRK 5,310 for insurance of freelance journalists, sportsmen and artists who pay income tax after deductions, as well as for members of the management board of companies; and for work performed abroad with foreign employers or international organisations and for work performed in Croatia with employers who have their seats in foreign countries. For prolonged insurance of seamen: HRK 2,655 for unskilled workers or persons with no qualifications, HRK 3,717 for persons with low qualifications or semi-skilled workers, HRK 5,310 for persons with secondary school qualifications or skilled workers, HRK 7,434 for persons with post-secondary qualifications or highly skilled workers and HRK 8,496 for persons with university degrees.
on contributions, also determined as a percentage of average gross wages of employees in Croatia in previous year(s). It is currently set at 600 percent.

As for the contribution rate, all insured persons including farmers currently pay 20 percent of their gross wages for mandatory pension insurance.53 In Croatia, as previously explained, the contribution is paid fully by employees without an employer matching payment.

An additional word of explanation is needed concerning the second pillar contributions of two special groups described in Section 2.3., those who opt for voluntary “prolonged insurance” and those with difficult jobs or physical limitations whose insurance periods are of “extended duration,” that is, given extra weight in the benefit formula. Originally the first category was exempt from the second pillar contributions.54 However, since July 4, 2003, they must be insured under the second pillar under the same conditions as other workers. The contributions for insurance periods with extended duration vary from 4.86 percent to 17.58 percent of wages or contribution base, depending on the degree of extension, and are distributed proportionally between the two pillars.55

In 2002, the contribution requirement was extended to an important new category of income, namely, from temporary contracts and atypical self-employment.56 By paying contributions on this income, these individuals acquire the status of an insured person during the year in which the contributions are paid. In that way the obligation to, and rights arising from, pension and health insurance will be equalised across different forms of work. Also, distortions on

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53 The Law on Contributions for Mandatory Insurance (Zakon o doprinosima za obvezna osiguranja – OG 147/02) states that the insured persons and contribution bases are the same for both pillars.

54 Article 17 of the Pension Insurance Law (OG 102/98).

55 Law on Insurance with Extended Duration (OG 71/99).

56 Examples are teleworking and honoraria. In the latter case, many media companies paid their employees at the minimum wage (thus allowing them to receive health insurance and the minimum pension insurance). The employees then received their additional income as honoraria or through contracts that were not subject to contributions. This extension of the contribution requirement was made by the Law on Contributions for Mandatory Insurance (Zakon o doprinosima za obvezna osiguranja – OG 147/02).
the labour market caused by differing labour costs will be reduced, the future pension rights of atypical workers will be greater, and revenues from pension contributions increased.

For voluntary pension and health insurance, contributions of up to HRK 1,050 per month are deductible from personal income tax.

### 3.2. Employees

Contribution rates for pension and disability insurance during 1994–2003 are shown in Table 5. It shows a progressive shift of the contribution from employers to employees. Since 2003, the contribution has been paid entirely by employees. However, one should not overestimate the significance of this shift, because the overall shares of employee and employer social contributions have not changed significantly. Thus, in 2002, the total employer social contribution rate was 17.07 percent; and the total employee social contribution rate was 20.60 percent. Beginning in 2003, the total employer social contribution rate is 17.2 percent; and the employee social contribution rate is 20.0 percent. To put it simply, the health insurance contribution is now borne wholly by the employer, whereas the pension insurance contribution is borne wholly by the employee.

Beginning in 1994, firms, institutions and other legal entities were relieved of paying contributions for pension and disability insurance on the salaries of Croatian soldiers; that is, Homeland War veterans that they employ, as well as for those workers who have participated in professional rehabilitation. Firms that employ disabled persons were also exempted from paying contributions on their wages.

As can be seen in Table 5, contribution rates for pension and disability insurance were reduced in 1995 (OG 95/94). This was done in concert with a broadening of the contribution base to include some fringe benefits – i.e. holiday remuneration and supplements for daily meals. However, those forms of compensation, subsidies, and awards that are exempt from Personal Income Tax are still not considered as part of the salary and are thus also not subject to contribution payment.
### Table 5
Contribution Rates for Pension and Disability Insurance, 1994–2002 (in %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Employee</th>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>13.50</td>
<td>13.50</td>
</tr>
<tr>
<td>1995</td>
<td>12.75</td>
<td>12.75</td>
</tr>
<tr>
<td>1996</td>
<td>12.75</td>
<td>12.75</td>
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<tr>
<td>1997</td>
<td>12.75</td>
<td>12.75</td>
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<tr>
<td>1998¹</td>
<td>10.75</td>
<td>10.75</td>
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<tr>
<td>1999</td>
<td>10.75</td>
<td>10.75</td>
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<tr>
<td>2000¹</td>
<td>10.75</td>
<td>8.75</td>
</tr>
<tr>
<td>2001</td>
<td>10.75</td>
<td>8.75</td>
</tr>
<tr>
<td>2002</td>
<td>10.75</td>
<td>8.75</td>
</tr>
<tr>
<td>2003</td>
<td>20.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>

**Note:** For 1998 the employee rate is valid from February 1; for 2000, the employer rate is valid from June 1.

**Source:** Zakon o placanju doprinosa za MIO radnika, OG 117/93, 95/94, 106/95, 108/96, 164/98, 71/99, 149/99, 54/00, 63/00, Zakon o mirovinskom osiguranju 102/98.

Starting in 1999, the three categories of contribution rates were eliminated (see Section 1.1.), thereby equalising the rates of pension insurance for all workers. In addition, the exemption from the contribution requirement for employers of war veterans was limited to one year.

### 3.3. Self-employed

The contribution base for self-employment income has been brought in sync with the personal income tax base.\(^{57}\) Items which are treated as self-

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\(^{57}\) The personal income tax base is defined as income after deduction of social contributions and other allowed tax deductions.
employment income include earnings from a small business, an independent profession (e.g., lawyer, architect, journalist), and agriculture and forestry, as well as other self-employment activities.\(^{58}\)

### 3.4. Farmers

From 2000 to 2002, the contribution rate for farmers and members of their families was 9.75 percent, while government contributed the remaining 9.75 percent. Experience with compliance during these years was negative: the government paid its share on time, but fewer than 25 percent of farmers did so. Since 2002, the contribution rate of 20 percent is fully paid by farmers, with no government match.

The contribution base for most farmers is 40 percent of the average wage in Croatia. For those classified as self-employed or incorporated businesses (VAT payers), it is the earnings that are counted for income tax purposes, as described in subsection 3.3.

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\(^{58}\) Income from small businesses includes manufacturing, services, trading, catering, and transportation. In addition, the sale of more than three items of real property (or property rights of the same type) in a period of five years is taxed as a small business activity, as is leasing out an entire small business. Two types of professional income can be distinguished: income from independent professions and income from other self-employment activities. Independent professions are those carried out by physicians, veterinary surgeons, writers, inventors, translators, scientists, lecturers, etc. Other self-employed activities are those carried out by (a) members of Parliament, members of supervisory or management boards in firms, bankruptcy administrators and (b) occasional independent activities, such as those of scientists, artists, experts and journalists, provided this activity is besides some other primary activity or employment. Occasional activity is defined as not being performed within regular employment, and if the activity is being carried out from time to time, with longer discontinuity and only for a short period. If the self-employed person is insured in the second pillar, s/he pays 15 percent of the contribution base to the first pillar and five percent to the second pillar.
Like the self-employed generally, if small farmers are included in the second pillar, the contribution rate is divided: a 15 percent contribution rate is earmarked for the first pillar and five percent to the second pillar.\textsuperscript{59}

3.5. Others

When disabled war veterans receive compensation in lieu of salary or if they are unemployed, the Croatian Employment Service pays their pension contributions. For insured persons with special rights to pension insurance (for example, the blind or recipients of disability pensions who have the right to a full pension with reduced contributions), the differences between what they would otherwise be required to pay and what they actually pay is covered by the Republic of Croatia. This rule has applied since 1996.

For certain persons with disabilities, pension insurance for extended duration (as described in Section 2.3.) is paid by the Republic of Croatia at the rate of 7.84 percent.\textsuperscript{60} This has been in effect since 1999.

In 1999, the contribution requirement was extended to so-called salary compensation. This compensation is paid to insured persons who do not work because of justified reasons (illness, maternity leave, part-time work because of caring for a disabled child, etc). Until the end of 1998, these periods of non-gainful activity were included in the insurance period, though no pension contribution was paid. Under the new requirement, the contributions are paid by the Republic of Croatia Centres for Social Work and Welfare and the Croatian Health Insurance Institute at the rate of 16.50 percent. The salary compensation is, however, still exempt from income tax, health insurance

\textsuperscript{59} Small farmers are farmers not registered with the Tax Administration, either for VAT or as self-employed persons. If farmers are registered for VAT or are registered as self-employed persons, their treatment for contribution payment is the same as that of self-employed persons.

\textsuperscript{60} These include insured blind persons, persons suffering from dystrophy and similar muscular diseases, cerebral and child paralysis, multiple sclerosis, and rheumatic arthritis; paraplegics, deaf people, and persons that have functional problems and are unable to move without a wheelchair.
contributions, and unemployment contributions. For unemployed Croatian war invalids from the Homeland War, the Croatian Employment Services pay the pension contribution at the rate of 16.75 percent. Generally though, unemployed persons are pension insured only if they are sufficiently close to retirement age. 61 If the insured person is included in the second pillar, a proportional share must be paid to his or her chosen second pillar savings fund.

Since January 2003, the above institutions no longer pay first pillar contributions but continue to pay the second pillar contribution, where applicable. The rationale is that if the latter are not paid, the individual’s future pension will be negatively affected, whereas periods out of the work force for the reasons mentioned above are counted by law in the computation of first pillar benefits, whether or not contributions are paid. Significantly, the Centres for Social Work and Welfare and the Croatian Health Insurance Institute pay these contributions at the rate of five percent of net compensation. This means that a smaller amount of contributions is paid on their individual accounts in selected savings funds.

4. Number of Contributors, Pension Coverage, and Measures of Effectiveness of Contribution Collection

As can be seen in Table 6, the total number of active insured persons in the public pension system decreased by almost 590,000 during 1990–2000. The absolute reduction was greatest for employees (almost 460,000), while the relative decline was greatest for farmers, as their number in 2000 represented only some 36 percent of the 1990 figure. However, the number of contributors started to increase in 2001 (by some 22,000), with a further increase in 2002 (by some 20,000).

In order to obtain a broad estimate of the number of active persons not included in the pension system, the total number of contributors can be

61 That is, if they will reach pensionable age in five years or less. In that case the state budget covers the contribution.
compared with the number of persons in employment. The precision of this estimate is weak due to the changing methodology of the Labour Force Survey (LFS) and the changing sample design. Bearing this in mind, one could nevertheless state that the extent of non-inclusion is rather low.

### Table 6
**Number of contributors to the public pension system and persons in employment, 1990–2002**

<table>
<thead>
<tr>
<th>Year</th>
<th>Employees</th>
<th>Self-employed</th>
<th>Farmers</th>
<th>Total</th>
<th>Persons in employment (thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>1,682,971</td>
<td>68,744</td>
<td>217,022</td>
<td>1,968,737</td>
<td>—</td>
</tr>
<tr>
<td>1991</td>
<td>1,555,734</td>
<td>68,535</td>
<td>214,996</td>
<td>1,839,265</td>
<td>—</td>
</tr>
<tr>
<td>1992</td>
<td>1,442,406</td>
<td>66,000</td>
<td>216,386</td>
<td>1,724,792</td>
<td>—</td>
</tr>
<tr>
<td>1993</td>
<td>1,410,638</td>
<td>66,726</td>
<td>220,774</td>
<td>1,698,138</td>
<td>—</td>
</tr>
<tr>
<td>1994</td>
<td>1,384,594</td>
<td>73,461</td>
<td>163,846</td>
<td>1,621,901</td>
<td>—</td>
</tr>
<tr>
<td>1995</td>
<td>1,340,951</td>
<td>77,549</td>
<td>149,481</td>
<td>1,567,981</td>
<td>—</td>
</tr>
<tr>
<td>1996</td>
<td>1,267,650</td>
<td>81,095</td>
<td>130,230</td>
<td>1,478,975</td>
<td>1,540.3</td>
</tr>
<tr>
<td>1997</td>
<td>1,270,226</td>
<td>79,962</td>
<td>118,750</td>
<td>1,468,938</td>
<td>1,493.0</td>
</tr>
<tr>
<td>1998</td>
<td>1,282,576</td>
<td>80,021</td>
<td>108,912</td>
<td>1,471,509</td>
<td>1,543.8</td>
</tr>
<tr>
<td>1999</td>
<td>1,239,200</td>
<td>76,629</td>
<td>90,262</td>
<td>1,406,091</td>
<td>1,491.6</td>
</tr>
<tr>
<td>2000</td>
<td>1,224,178</td>
<td>77,331</td>
<td>79,001</td>
<td>1,380,510</td>
<td>1,553.0</td>
</tr>
<tr>
<td>2001</td>
<td>1,247,709</td>
<td>78,783</td>
<td>73,610</td>
<td>1,402,102</td>
<td>1,469.5</td>
</tr>
<tr>
<td>2002</td>
<td>1,274,293</td>
<td>80,471</td>
<td>67,217</td>
<td>1,421,981</td>
<td>1,527.2</td>
</tr>
</tbody>
</table>

**Notes:** Until 1994, the data includes all insured farmers, and from 1994, only those insured farmers are included for whom assessment and contribution collection were performed.

The Labour Force Survey started in 1996. In 2001 and in previous years the database of the Croatian Electric Utility was used for the sample frame. In 2002 a new sample, based on the 2001 census data, was used.

Table 7 shows the amount of contributions collected by groups of insured persons in the period 1990–2002.

<table>
<thead>
<tr>
<th>Year</th>
<th>Employees</th>
<th>Self-employed</th>
<th>Farmers</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>33,660</td>
<td>459</td>
<td>138</td>
<td>34,256</td>
</tr>
<tr>
<td>1991</td>
<td>41,113</td>
<td>756</td>
<td>225</td>
<td>42,094</td>
</tr>
<tr>
<td>1992</td>
<td>162,255</td>
<td>2,431</td>
<td>935</td>
<td>165,621</td>
</tr>
<tr>
<td>1993</td>
<td>2,476,626</td>
<td>37,102</td>
<td>8,059</td>
<td>2,521,787</td>
</tr>
<tr>
<td>1994</td>
<td>7,608,790</td>
<td>157,268</td>
<td>23,058</td>
<td>7,789,110</td>
</tr>
<tr>
<td>1995</td>
<td>9,449,789</td>
<td>179,489</td>
<td>57,328</td>
<td>9,686,605</td>
</tr>
<tr>
<td>1996</td>
<td>10,577,652</td>
<td>215,154</td>
<td>78,059</td>
<td>10,870,865</td>
</tr>
<tr>
<td>1997</td>
<td>11,871,307</td>
<td>266,378</td>
<td>76,663</td>
<td>12,214,348</td>
</tr>
<tr>
<td>1998</td>
<td>11,439,117</td>
<td>244,446</td>
<td>82,763</td>
<td>11,766,326</td>
</tr>
<tr>
<td>1999</td>
<td>12,039,717</td>
<td>302,768</td>
<td>116,138</td>
<td>12,458,624</td>
</tr>
<tr>
<td>2000</td>
<td>12,415,552</td>
<td>322,503</td>
<td>116,032</td>
<td>12,854,087</td>
</tr>
<tr>
<td>2001</td>
<td>12,854,136</td>
<td>315,144</td>
<td>91,978</td>
<td>13,261,258</td>
</tr>
<tr>
<td>2002</td>
<td>12,138,155</td>
<td>312,646</td>
<td>79,355</td>
<td>12,530,156</td>
</tr>
</tbody>
</table>

**Note:** From the beginning of 1999, the data for self-employed and farmers are taken from payment accounts at the CPII. For the years before the introduction of the Croatian Kuna (HRK), data is recalculated. For 2002, the amount refers only to the contributions collected for the first pillar. The amount collected for the second pillar was HRK 1,923,552,000, giving a total of contributions collected in the first and second pillars of HRK 14,453,708,000.

**Source:** Croatian Pension Insurance Institute, except the cumulative amount of collected gross contributions for the second pillar in 2002, where the source is HAGENA: *Izvjesce o mirovinskim trzistima u Republici Hrvatskoj*, Zagreb, 2003, p.24.

In order to look more deeply at compliance trends, we will analyse two additional measures. The first is the effective contribution rate. It is obtained
by dividing (a) the actual contribution revenue collected; and (b) the aggregate contribution base.\(^62\) The effective contribution rate can be compared with the statutory contribution rate in order to ascertain how much of the potentially collectable contributions are actually collected. Here we in fact analyse only compliance for insured persons – either subgroups (such as employees) or the whole group – i.e. all insured persons. Table 8 presents the relevant data for Croatia for the period 1996–2002.

<table>
<thead>
<tr>
<th>Year</th>
<th>Employees</th>
<th>All insured persons</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Statutory contribution rate</td>
<td>Effective contribution rate</td>
</tr>
<tr>
<td>1996</td>
<td>0.255</td>
<td>0.214</td>
</tr>
<tr>
<td>1997</td>
<td>0.255</td>
<td>0.212</td>
</tr>
<tr>
<td>1998</td>
<td>0.216</td>
<td>0.180</td>
</tr>
<tr>
<td>1999</td>
<td>0.215</td>
<td>0.178</td>
</tr>
<tr>
<td>2000</td>
<td>0.203</td>
<td>0.174</td>
</tr>
<tr>
<td>2001</td>
<td>0.195</td>
<td>0.170</td>
</tr>
<tr>
<td>2002</td>
<td>0.195</td>
<td>0.171</td>
</tr>
</tbody>
</table>


\(^62\) The effective contribution rate can be computed for employees, in which case the contribution revenue collected refers to collected contributions on behalf of employees; the aggregate contribution base is computed by multiplying the average wage by the number of employees. The effective contribution rate can also be computed for all insured persons. In that case the contributions collected refer to the actual total amount of collected contributions from all insured persons, whereas the aggregate contribution base is computed by multiplying the average wage by the number of insured persons. Of course, such a computed aggregate contribution base does not take into account the fact that the average contribution base for the self-employed and farmers is not equal to the average wage, even in the best of circumstances.
Table 8 suggests that contribution compliance has been improving since 2000. Thus in 2000 contributions collected on behalf of employees reached 85.3 percent, and in 2002, 87.8 percent of the maximum attainable amount. Similarly, the ratio between the effective contribution rate and statutory rate for all insured persons has also been increasing and in 2002 reached 81.2 percent of the maximum attainable amount. Though the increase in this ratio is caused by improved compliance among the largest group of insured persons – i.e. among employees – this is not the only cause. The improvement might also be due to the changed structure of insured persons; in particular the share of low contributors – insured farmers – decreased. Another factor which might have increased the ratio is the relative increase in the contribution base for the self-employed: in 1996 the average amount of collected contributions per self-employed amounted to 32 percent of the average amount of collected contributions per employee, and by 2002 this increased to 41 percent.

The second important measure of contribution compliance is the covered wage bill. This measure shows the amount of wages which, assuming the given statutory contribution rate, would have generated the actual amount of contribution revenues collected on behalf of employees. The covered wage bill is usually related to GDP. Its values are presented in Table 9.

The relatively high values of the covered wage bill which we observe in Table 9, compared to other countries in this study, can signify not only relatively high contribution compliance by employees but also rather low shares of other income sources in GDP. In particular, we refer to mixed income (i.e. income

63 We have to repeat that this figure is obtained on the basis of several assumptions. We assume that the average contribution base for all groups of insured persons is equal to the average wage. This assumption is actually valid only for employees, whereas the self-employed and farmers have different contribution bases. We also assume that the statutory contribution rate for all contributors is equal to the statutory contribution rate for employees, which is not valid for farmers, as their contribution rate is only half of the contribution rate for employees.

64 As can be observed in the overview chapter, the level of the Covered Wage Bill in Croatia is higher than in all other countries in this study, including Slovenia. This may be attributable to the fact that wage and GDP statistics in Croatia are still not fully reliable and probably underestimate the true values. Namely, Croatia has not yet applied
from self-employment) and gross operating surplus, i.e. corporate income. The trend value of the covered wage bill (measured as percentage of GDP) has been slightly on the rise, as the covered wage bill amounted to 38.5 percent of GDP in 1998 and 40.8 percent in 2002. However, it is not possible to ascertain what factor explains this slight (but important) improvement: is it pension reform in general, institutional reform and administrative changes, or improvement of general economic conditions? This would doubtlessly require further study.

<table>
<thead>
<tr>
<th>Table 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>The covered wage bill (as % of GDP), 1996–2002</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GDP (million HRK)</th>
<th>Employee contributions (million HRK)</th>
<th>Contribution rate (employee + employer)</th>
<th>Covered wage bill (as % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996 107,981</td>
<td>10,578</td>
<td>0.255</td>
<td>38.4</td>
</tr>
<tr>
<td>1997 123,811</td>
<td>11,871</td>
<td>0.255</td>
<td>37.6</td>
</tr>
<tr>
<td>1998 137,604</td>
<td>11,439</td>
<td>0.216</td>
<td>38.5</td>
</tr>
<tr>
<td>1999 141,579</td>
<td>12,040</td>
<td>0.215</td>
<td>39.6</td>
</tr>
<tr>
<td>2000 152,518</td>
<td>12,415</td>
<td>0.203</td>
<td>40.0</td>
</tr>
<tr>
<td>2001 165,639</td>
<td>12,854</td>
<td>0.195</td>
<td>39.8</td>
</tr>
<tr>
<td>2002 176,429</td>
<td>14,047</td>
<td>0.195</td>
<td>40.8</td>
</tr>
</tbody>
</table>

Sources: For GDP, the 2003 Statistical yearbook of the Republic of Croatia; for employee contributions collected, the CPII.

Yet another measure of contribution compliance may be obtained by comparing the covered wage bill with the actual wage bill; the actual wage bill is obtained from the national accounts statistics. This is provided in Table 10, which shows an increasing value of this ratio. In other words, contribution

the European System of Accounts (ESA), and an estimate of unrecorded activities is not incorporated in GDP, while these estimates are – to a certain extent – included in the GDP estimates of most of the other countries.
compliance has been improving within the formal sector. Table 10 indicates that in 2001 less than nine percent of all earnings (i.e. of all labour income) in the formal sector evaded payment of pension contributions.\textsuperscript{65}

<table>
<thead>
<tr>
<th>Year</th>
<th>Covered wage bill (1)</th>
<th>Actual wage bill (2)</th>
<th>1/2 • 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>52,958</td>
<td>61,272</td>
<td>86.4</td>
</tr>
<tr>
<td>1999</td>
<td>56,000</td>
<td>65,283</td>
<td>85.8</td>
</tr>
<tr>
<td>2000</td>
<td>61,067</td>
<td>69,570</td>
<td>87.8</td>
</tr>
<tr>
<td>2001</td>
<td>65,918</td>
<td>72,139</td>
<td>91.4</td>
</tr>
</tbody>
</table>

Source: Central Bureau of Statistics, Republic of Croatia (for actual wage bill).

5. Non-compliance and Evasion

5.1. Non-compliance in Large Enterprises

Company bailouts and debt conversion into equity are the most common measures resorted to by the Croatian Government as a form of state aid to loss-making firms and/or as an attempt to rehabilitate state-owned enterprises (SOE). The problems of non-compliance in large enterprises are still serious and primarily involve shipyards, railways, and agro-processing firms, which were accustomed to receiving explicit transfers, soft loans, and discriminatory

\textsuperscript{65} Madzarevic-Sujster (2001) reached a somewhat different conclusion with regard to contribution compliance. She carried out simulations for the period from 1994 to 2000, and concluded that the evasion of direct taxes and contribution as a percentage of GDP rose from 4.3 percent to 5.9 percent in the same period. Madzarevic-Sujster underlines that the mentioned simulation gives the lower limit of the estimation.
protection, as well as exemptions from fiscal obligations. Thus, in February 2001, the government adopted a provisional measure for the consolidation of companies in agriculture, in which it authorised the relevant ministries to write off their claims, reschedule them, or convert them to equity. According to government estimates, the contribution and tax debts of the large agricultural companies amounted to some HRK 2.2 billion (Jutarnji list, 2001). Madzarevic-Sujster (2001) estimates that during the period 1994–2000, the cumulative amount of contributions that should have been paid, but which was written off by governmental decree or legislative acts, is in the range of 0.3 to 0.5 percent of GDP.

While these measures were aimed at protecting the jobs of employees in state-owned enterprises, it can be argued that they actually had the opposite effect: by delaying restructuring and maintaining unequal conditions for private investment, they discouraged the entry of new firms, expansion of existing firms, and sustainable job creation.

As the privatisation process in Croatia was non-transparent, it also had a direct influence on the pension system and on contribution compliance. Some privatisation transactions involved direct sales and transfers of state shares in these enterprises, without settling the contribution debt.

5.2. Evasion or Weak and Partial Compliance in the Formal Sector

In Croatia, many employers pay contributions for their employees on the minimum contribution base. These employers tend to be concentrated in the building industry, hotels and catering, and retail trade – all types of employment that are likely involve younger workers who must also be insured in the second pillar. Since benefits from the second pillar will depend directly on contributions paid and, under the accumulation system, those contributions paid earlier in life will normally yield greater investment returns, this form of evasion can be expected to cause a significant reduction in future pensions. Before REGOS began providing annual information on contributions paid, there were no reliable data on the numbers of these workers. The new REGOS data provide some insights. For June 2003, of all the received R-S forms, 8.1 percent included an insurance base of less than
HRK 1,858.50, and in 3.3 percent the base was equal to HRK 1,858.50. See Table 11. In other words, by mid-June 2003, some 11.4 percent of all insured persons in the mandatory pension system had a contribution base that was below the minimum contribution base for employees.66

<table>
<thead>
<tr>
<th>Insurance base (in HRK)</th>
<th>Less than 1,858.50</th>
<th>Equal to 1,858.50</th>
<th>More than 1,858.50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid</td>
<td>91,055</td>
<td>33,889</td>
<td>1,010,221</td>
</tr>
<tr>
<td>Unpaid</td>
<td>6,052</td>
<td>5,630</td>
<td>51,590</td>
</tr>
<tr>
<td>Total</td>
<td>97,107</td>
<td>39,519</td>
<td>1,061,811</td>
</tr>
</tbody>
</table>

*Source:* REGOS.

These workers face serious disadvantages with respect to the calculation of their pensions. If an employee is registered for purposes of social insurance, but there is no proof of wages actually having been disbursed and pension contributions paid, this “insurance period” is counted only for purposes of acquiring sufficient years for pensioning. The pension amount is computed only on the basis of actual wages disbursed (i.e., there must be proof that the worker was paid). If there is no proof of wages being paid, the accrual rate for pensions for that “insured” year is 0 percent.

Zuber (2000) points to some additional areas in which evasion may be occurring. She notes that, while the minimum contribution base and number of insured persons who pay contributions on the lowest base are both known in Croatia (as shown in Table 11), there is no information on whether these persons have, from the same payer, any income from profit sharing or dividends, which in many private firms is an important form of remuneration.

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66 The insurance base HRK 1,858.50 is for full-time work. Some of the insured persons could be insured for part-time work.
There is also no information on the frequency of part-time work (except that provided by the Labour Force Survey), nor is there any information on the numbers of occasional and temporary jobs. Yet another unknown is the amount that pensioners earn in addition to their pensions.

5.3. *The Problem of Arrears*

No doubt the problem of arrears in Croatia is serious, but there is a lack of relevant information and data, as the CPII has ceased to analyse and monitor this phenomenon. According to the internal publication of CPII (*Hrvatski zavod za mirovinsko osiguranje*, 2000), arrears in 1998 amounted to HRK 4.03 billion, with the largest part representing arrears from legal entities (54.5 percent, or HRK 2,194) while the remainder (45.5 percent, or HRK 1.834 billion) was attributable to craftsmen, farmers, and self-employed. The largest share of arrears by legal entities was that of shipyards (38 percent, or HRK 822 million). In 1998, total arrears amounted to 24.4 percent of CPII expenditures.

6. **Improving Compliance**

6.1. **Legal Changes and Related Problems**

Over the last two years (2002–03), there were important amendments of laws and regulations related to pension contributions (see Section 3), as well as some significant organisational improvements in collections.

With the amendments of the Labour Law accepted by Parliament on July 14, 2003 (OG 114/2003), legal preconditions were established for an employee to sue his/her employer for unpaid *gross* salary. However, conforming changes are still required in other laws to remove inconsistencies with this new right.

At the same session, however, Parliament amended the Bankruptcy Law (OG 123/03), so that workers in insolvent firms can sue an employer for only the *net* wages, while contributions are defined as claims of authorised bodies.
Taken together, these laws mean that workers can sue their employers for the unpaid amount of *gross* wages (which includes personal income tax and pension contributions) but, in the case of an insolvent firm, they can sue only for the unpaid amount of *net* wages.

Wages and contributions are treated quite differently in the new process. If an employer fails to pay all the mandatory contributions, the Tax Administration will enforce collection. There is though no coercive mechanism for ensuring that workers receive their net wages. However, once a firm is bankrupt, net salaries and severance pay take priority in settling liabilities to employees. After these liabilities are met, there may be no funds left to pay pension contributions.

### 6.2. Administrative and Organisational Changes

As previously described, the government introduced a number of measures in 1990 to reduce the administrative burden on employers and improve the efficiency and transparency of the tax and contribution systems. Apart from the introduction of the R–S form for unified reporting, the main measures to consolidate control and enforcement have been linked with the changed role of the Tax Administration. See Section 2.1.4. According to the World Bank (Anusic, O’Keefe, Madzarevic-Sujster, 2003), these reforms will lead to a more efficient system of control and enforcement of contributions. Yet it will be possible to make a full evaluation of these changes only after they are complete. Currently there is still much replication in collecting data, which burdens contribution payers and increases administrative costs. Furthermore, continuing controversy on the respective roles of REGOS and the Tax Authority makes the future direction of policy making on collections difficult to predict.
References


Sector Unit, South Central Europe Country Unit, Europe and Central Asia Region.


