



Weekly Briefing

**Bosnia-Herzegovina social briefing:
Pension system in Bosnia and Herzegovina
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Pension system in Bosnia and Herzegovina

Summary

Two entities in Bosnia and Herzegovina have been operating separate public pension systems. Pension reforms in the Federation of Bosnia and Herzegovina have been only minimal, although broader reforms have been considered necessary. Republika Srpska led the reform process by launching a pension reform in 2011 to restore its fiscal balance and reduce pension contribution arrears. Reforms in Federation of Bosnia and Herzegovina have been implemented only since March 2018, resulting in a system with similar parameters to those of RS.

Introduction

The Pension and Disability Insurance System in Bosnia and Herzegovina is a classic Bismarckian type labour-based system of social insurance with a progressive ‘single pillar’. Accrual of pension rights is based on payment of contributions, and the level of the final pension benefit is determined by the level of salary/wage during the active insurance period, adjusted for annual accrual rates. Contributions are paid into an autonomous extra budgetary fund and are mandatory for all employed persons. The existing pension system is based on traditional principles of social insurance: principle of legality; rights from pension insurance, conditions for acquiring those rights and quantification of those rights as defined by law; principle of intergenerational solidarity: reciprocity and solidarity.

Reform process of pension system

Two entities in Bosnia and Herzegovina have been operating separate public pension systems. Republika Srpska (RS) led the reform process by launching a pension reform in 2011 to restore its fiscal balance and reduce pension contribution arrears. Reforms in Federation of Bosnia and Herzegovina (FBiH) have been implemented only since March 2018, resulting in a system with similar parameters to those of RS. The outlook of both pension systems is stable for the next decade, during which both entities would need to consider further pension reforms. These reforms would need to improve pension adequacy and ensure fiscal and social

sustainability of the pension system, such as raising the retirement age and tightening early retirement options, as well as implementing policies to improve labor participation. With pension system parameters temporarily sustainable, the focus of reforms in both entities has increasingly been on improving administrative capacity and user-friendliness of pension administration; addressing specific pension system issues such as early retirement in hazardous occupations, privileged pensions, and the disability assessment process; and reducing the stock of unpaid pension contributions. Unpaid pension contributions in both entities have been mounting over the past three decades, creating eligibility obstacles for insured individuals and financial problems for the fiscal authorities. In both entities, great legal and organizational efforts have been put into developing and encouraging voluntary pension savings through tax stimulus and automatic enrollment in a voluntary opt-out model.

Pension reforms in the FBiH have been only minimal, although broader reforms have been considered necessary. New legislation on Pension Insurance in the FBiH was enacted in March 2018. Even though this legislation addresses the long-term fiscal sustainability problems in the pension system, the PAYG system still prevails. The defined benefit system of the past is being replaced by the introduction of a defined contributions system. Requirements for receiving an early old-age pension will be significantly stricter than before. The requirement for early retirement in 2018 for men was 35.5 years of paid pension insurance and 60.5 years of age, while for women it was 30.5 years of pension insurance and 55.5 years of age. This limit will increase for both men and women every year by half a year of age and half a year of paid pension insurance before reaching the 40-year limit of paid pension insurance. A more rigorous set of benefit reductions has been introduced, which act as a disincentive to early retirement: 4% annual reduction compared to prior 0.5% reduction for each year below age 65, according to the Law on Pension and Disability Insurance from 2019. In the first months after the adoption of the new law, 39% of the elderly population (65 years of age and older) may not be collecting any increase in state pension. Legislation created an increase that applied to 54,785 pensioners whose pensions increased by 10%, and another 53,454 who received an increase of 5%. Another outcome of the reform was that the deficit of the pension insurance fund was reduced.

In the RS, the right to a retirement pension can be reached at 65 years of age, if she or he has been paying insurance contributions for at least 15 years. An insured person who has not reached the age of 65 but who has 40 years of work experience and insurance contributions can retire at the age of 60. Women may retire earlier than men; at age 58 if they have paid 35 years' pension insurance. A widow is entitled to a family pension if, when her husband dies, she is over the age of 50 or over 45 and incapable of working.

The status quo and reform orientation of pension system

The pension system in Bosnia and Herzegovina has two components: a public pension system (age pension and disability pension) and voluntary, private pension insurance which is an open voluntary pension funds with no limitations on membership and closed voluntary funds where membership is limited to specific groups (e.g. employees of specified employers). The risks covered by pension and disability insurance are: old age, disability, death and physical disability. Rights arising from these risks are: the right to an old-age pension, disability and family pension, as well as the right to an allowance for physical disability. Over 80% of older persons are pensioners; of these, about 10% receive wartime disability allowances and about 5% receive social welfare. As a condition for receiving an old-age pension, an insured person is entitled to an old-age pension when he or she attains 65 years of age and at least 15 years of insurance, or at least 20 years of pensionable service, or when he/she attains 40 years of insurance service regardless of his/her age, according to Article 40 of the Law on Pension and Disability Insurance from 2018. Pension insurance is mandatory for: a person employed on a labour contract, a self-employed person, clerics and farmers. A person who does not pay compulsory insurance may pay voluntary insurance under certain conditions, as provided for by the law. An insured person has the right to financial compensation in the case of physical damage caused by injury at work or occupational diseases or if they need care. A person not involved in the compulsory insurance system can pay voluntary insurance, as there is no legal obligation to do so, under certain conditions. Voluntary pension funds fall into Pillar III of pension insurance, a voluntary component of the pension system.

The high spending on pensions is partly the result of many people receiving disability pensions at pre-retirement age. According to the data of Agency for Statistics of Bosnia and Herzegovina, many working-age people receive pensions, but around 39% of older people may not be collecting any state pension.

Challenges and development trend of pension system

The situation in pension funds is very similar in both entities of Bosnia and Herzegovina. For example, approximately 58% of all funds available in the FBiH are for old-age pensions, 16% for disability and 25% for family pensions. The share of old-age pensions has been increasing in both entities. The average size of pension benefits in both entities is very low. Average pensions in the FBiH and RS amounted to approximately € 189 and € 175 per month,

respectively. From 2010, the average values of pensions have been mostly stagnant while the number of pension beneficiaries has been increasing. The amount of average pension is almost the same between the FBiH and RS. In relative terms, the average pension is 31% of the average gross wage. However, in view of the pension formula and the fact that the average total number of insurance contributions is 33 years, the replacement rates documented above suggest that there are certain pensioners who have had short periods of contributions but who have managed to be eligible for pensions.

Conclusion

Reforms in Federation of Bosnia and Herzegovina have been implemented only since March 2018, resulting in a system with similar parameters to those of Republika Srpska. The outlook of both pension systems is stable for the next decade, during which both entities would need to consider further pension reforms. These reforms would need to improve pension adequacy and ensure fiscal and social sustainability of the pension system, such as raising the retirement age and tightening early retirement options, as well as implementing policies to improve labor participation.