

## The Pension System of Bosnia and Herzegovina: Problems and Perspectives

**Nikolina Bošnjak**

Ph. D student at Faculty of Economics, University of Rome "La Sapienza", Italy

*nikolina.bosnjak@uniroma1.it*

### Abstract

The ageing of population, economic crisis and expectation that state should ensure the social security and adequate living standard to its citizens are imposing a big pressure on modern state budgets and pension systems. In this paper we will state all main problems of Pension System of Bosnia and Herzegovina, with a special accent on the political system interference in reform strategy and process. We will also identify the main guidelines for reform process, and once again emphasize the importance of benevolent political system into its implementation.

**Keywords:** Pay as You Go Pension System, Pension System Reform, Political System

### Introduction

The main role of Pension Systems is to provide stabile and adequate living standards to workers, when they are older and not able to work and earn anymore. The sustainable and stabile pension system is one of very important tasks of each modern state, since they are important part of social security system. It is a general trend nowadays that pension systems are under a big pressure to deliver adequate living standards to elder generations in conditions when population is ageing, and national economies have to overcome the crisis that hit them in the beginning of XXI century.

There is a big debate about the future of pension systems worldwide and new models and solutions that could improve the sustainability and disburden the state budgets. This paper is only a small contribution to that discussion, but one of the sparse papers that deals with the problem of Pension System of Bosnia and Herzegovina (hereinafter BiH).

The main topic of the paper will not be the technical computation of BiH Pension System sustainability, since bare data show that system is not sustainable even now, and we dare to say that any projections will show that BiH Pension System is rushing into a deeper chasm. The main topic here will be the identification of main challenges BiH Pension System it has to overcome, with emphasize on the political system influence and role.

The opinions stated here are author's point of view and conclusions regarding the one of the burning questions of BiH economic policy.

### Pension System of Bosnia and Herzegovina

The current Pension System of Bosnia and Herzegovina is, like the state, the successor of Former Yugoslavian Republic Bosnia and Herzegovina Pension System.

The civil war in BiH ended in December of 1995 when Dayton Peace Agreement was signed. As stated in Annex 4 of The Dayton Agreement, the Bosnia and Herzegovina is divided on two separate and highly autonomous entities – Federation of Bosnia and Herzegovina (hereinafter FBiH) and Republic of Srpska (hereinafter RS). Each of these two entities has its own constitution, legislation, government, and institutions. Still BiH is a complete state (not a confederation) with a central government, rotating state Presidency, central bank and constitution.

This duality exists in Pension system organization too. The Pension system of BiH consists of two separate Pension Funds - Pension Fund of FBiH (Federal Pension and Disability Institute) and Pension Fund of RS (Pension and disability insurance fund of Republic of Srpska).

Each of these funds operates in accordance to Laws of its entity. The both pension schemes are organized as public, pay-as-you-go schemes with mandatory participation for all employees, self-employed and farmers. The principles upon which the both pension schemes are laid down are intergenerational solidarity and mutuality. The insured are covered from risks of old age, disability and death<sup>1</sup>, while, in general, one must fulfill two conditions in order to be assigned a pension benefit - age of worker and years of contribution into the Fund.

### **Pension Fund of Federation of Bosnia and Herzegovina**

According to current laws, under which Federal Pension and Disability Institute operates, the insurant have rights on old-age pension benefit when:

she is 65 years old and has at least 20 years of pension insurance service which is consisted of years for which he have been insured and have been contributing into fund as an worker and years of special insurance service (years that he have been in the military during civil war);

she has 40 years of pension insurance service, no matter on his age.

Insurant also has right on early old-age pension benefit if he is 60 years old and has 35 years of pension insurance service (for males) and if she is 55 years old and has 30 years of pension insurance service (for females).

The amount of pension benefit paid is calculated as an accrual percentage from pension benefit basis. Pension benefit basis is calculated as an average from all incomes the employee had earned during his working (contributing) period. The accrual rate is 45% from pension benefit basis for first 20 years of pension insurance service and for each additional year of pension insurance service the accrual rate is enlarged for 1. 75 percentage points, so accrual rate maximum value is 75%.

The amount of pension benefit is permanently reduced for 0. 5% for women and 1% for men, for each year of earlier retirement (each year of retirement before they are 65 year old).

The pension benefits and administration of the Pension Fund are financed from contributions for pension and disability insurance that are paid into Fund each month, revenues from voluntary insurance, revenues from other activities of Pension Fund and from Federation budget transfers<sup>2</sup>. Current contribution rate is 23% from gross wage, where 17% is at the expense of the employee and rest of 6% is employer part.

### **Pension Fund of Republic of Srpska**

The revenues of Pension Fund are coming from wage contributions, voluntary insurance contributions, other Fund's activities and budget transfers. Current contribution rate in RS is 18. 5% on gross wage and contributions are main source of Pension Fund incomes. Budget transfers are covering war veteran pension benefits that are not acquired on the basis of contribution payment and insurance service, as in FBiH case.

There are two conditions that insured must satisfy in order to be eligible for an old age pension benefit. Those conditions are the age of insured and pension (insurance) service.

The insurer is qualified for an old age pension when:

---

<sup>1</sup> In case of insured death, the rights on pension benefit transits on dependent family members.

<sup>2</sup> Budget transfers are covering war veteran pension benefits that are not acquired on the basis of contribution payment and insurance service.

she is 65 years old and has 15 years of insurance service

she is 60 years old and has 40 years of pension service (for males)

58 years old and has 35 years of insurance service (for females)<sup>1</sup>.

The pension benefit amount depends on the level of wage earned during working period and on length of contribution period. Since 2011 Law on Pension and Disability Insurance the old age pension benefit amount is calculated using point method, where pension benefit amount is obtained when personal insured person's points are multiplied with value of general point valid at that moment.

General point value on the day when 2011 Law passed was 9. 241875 BAM and according to Article 82 and 83 of 2011 Law it should be harmonized each 1st of January. The rate of general point harmonization is equal to one half of sum of yearly rate of average net yearly wage change and rete of consumer prices change in pervious year on territory of RS.

Personal insured person points are obtained by multiplication of personal insured coefficient and duration of his pension service. Personal insured coefficient is obtained from division of sum of yearly personal coefficients with pension service duration period, while yearly personal coefficient is equal to ratio between total yearly incomes of insured person on top of which contributions are paid and yearly average wage for that year in RS (Federative Republic of Bosnia and Herzegovina). Yearly personal coefficient is calculated for each year starting from 1970 until the year of retirement, with exception of 1992 and 1993 when hyperinflation distorted the income figures, and its maximum value is 4.

### **Pension system of Bosnia and Herzegovina challenges**

Like the country itself, the pension system of BiH has many problems to deal with. In this paper we have an opportunity to identify the main challenges which have already been recognized by two main studies of Pension System of BiH – The Pension System Reform Strategy<sup>2</sup> (Government of Republic of Srpska, 2010) and Strategy of Reform of Pension System in FBiH<sup>3</sup> (Government of Federation of Bosnia and Herzegovina, 2013), but also to point out the importance of interference of political system into pension system functioning and reform.

The main problems identified by these two documents are:

The problems of BiH economy

Unsustainability of the System due to low dependency ratio

Demographic problems

Adequate living standard of elder, etc.

The economy of BiH has been ruined during the war conflicts, and it took 15 years for economy of BiH to reach again its pre-war GDP per capita level. After the war conflicts ended the Bosnian economy has experienced and great recovery mainly due to foreign aid and grants it has received. According to Central Bank of BiH in period 1996-2002, more than 6 billion of US \$ has been donated to BiH. These funds have mainly been used for financing of infrastructure rebuilding and

---

<sup>1</sup> These norms are still not used, because of transition period until 2025 that was designed for passage to these rules together with the creation of Pension and Disability Law from 2011.

<sup>2</sup> The Pension System Reform Strategy (2010) was the first analysis of Pension System of RS. It was done by the Working Group for Pension Reform which was formed by Government of RS with the task to create a Pension System Reform Strategy and new model of RS Pension System.

<sup>3</sup> The Strategy of Reform of Pension System in FBiH (2013) was done by the Working Group for Pension Reform Strategy, formed by the Government of FBiH.

technical assistance. In the following years, the foreign aid has decreased and BiH authorities have supplemented it with loans from international financial institutions.

In 2014 BiH had a GDP per capita of 7 084 BAM (3 622 EUR)<sup>1</sup> which positioned it as one of the poorest European countries. The biggest problems on Bosnian way to economic growth are big unemployment rate and negative trade balance. The unemployment rate was 27,5% of total labor force in 2014<sup>2</sup>, while youth unemployment was at extremely high level – around 60% in 2013. The high percentage of employed in public sector, compared to those in private sector imposes a big pressure on budget and public expenses.

BiH is having a negative balance of General Government budget for years and it amounts around 2% of GDP. This budget deficit is financed with borrowing, so current External debt of Bosnia and Herzegovina is 8,128 billion of BAM which presents around 30% of its GDP. The total external indebtedness of BiH is not so high, compared to other countries in its region, but the problem is in the way the money is used – mostly to finance current consumption. Almost 30% of State budget is being spent on public employees' wages, while 38% is transferred through social benefits system<sup>3</sup>. Thus there is no creation of the industrial base that would allow the country's loans repayment when the time comes.

The large consumption is mostly based on imported goods. BiH is having problem with growing negative net trade balance which reached 30% of GDP. The problem to reduction of trade balance deficit represents the unfavorable structure of traded goods. Bosnian export products are usually of low added value, while it imports products with high added value and highly technically sophisticate products.

The high unemployment rate and high number of pensioners at the same time caused the low dependency ratio of both BiH Pension Funds. The number of pensioners and insured together with dependency ratio for August 2015 are given in Table 1.

Table 1 – The Pension Funds dependency ratio

August 2015	Pension Fund of Republic of Srpska	Pension Fund of Federation of Bosnia and Herzegovina
Number of pensioners	250 812	397 032
Number of insured	284 765	451 248
Dependency ratio	1. 14	1. 14

The low dependency ratio is the measure of unsustainability of pension system. Pay-as-you-go systems are designed to perform well in young nations, where economy is growing and there is enough number of employed to sustain the pensions without any pressure for the system. The dependency ratio with whom PAYG system could work and be sustainable is 3, and in BiH we could not achieve that even if we would have full employment.

The situation with low dependency ratio will not improve in future. Nevertheless, according to UN projections it can only worsen. The main reason, beside the difficult economic situation, is unfavorable demographic structure and ageing of population, which is the general trend across almost all European countries. BiH is losing approximately 5 000<sup>4</sup> of its inhabitants annually due to negative natural increase of its population. The Natural increase rate has dropped from 5. 9‰ in 1996, to -1. 3‰ in 2013<sup>5</sup>, while the old-age dependency ratio<sup>6</sup> has increased from approximately 12 in 1996 to 22 in 2015, while projections on UN<sup>7</sup> say that in next 40 years this number will triple, so in future we can expect just higher

<sup>1</sup> World Bank Database data

<sup>2</sup> The registered unemployment rate is even higher. According to Agency for Statistics of BiH in 2014 it was around 44%.

<sup>3</sup> Central Bank of BiH database

<sup>4</sup> This number is, according to Agency for Statistics of Bosnia nad Herzegovina data, constantly increasing in last 6 years.

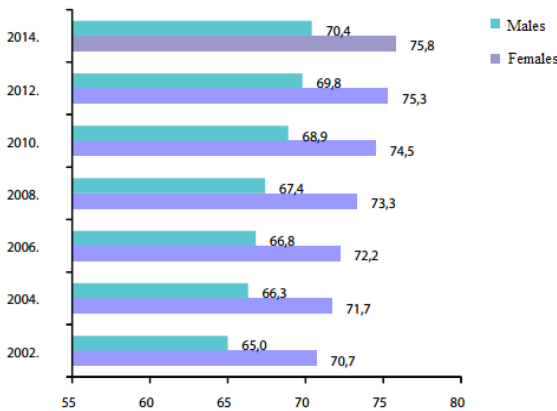
<sup>5</sup> Demographic bulletin of Agency for Statistics of Bosnia and Herzegovina

<sup>6</sup> It is measured as number of persons of age 65+ per 100 persons of age 15-64

<sup>7</sup> World Population Prospects: The 2015 Revision, United Nations, Department of Economic and Social Affairs, Population Division (2015)

pressure on Pension System and Budget of BiH. Apart from natural increase rate decrement, the pressure of increasing number of older population on Pension System is caused also by growth of expected life duration. Graph 1 shows us the movement of average age of deceased in last 7 years in BiH.

Graph 1 – The average age of deceased in BiH



From the Graph 1 it is evident that elder people's life expectation is constantly increasing in BiH in last 7 years. This will inevitably put additional financial pressure on Pension Systems of Bosnia and Herzegovina in future.

Also, here we should mention the nonexistence of proper data upon which the analyst and policy planner could plan the Pension reform strategy. The results of last census of 2013<sup>1</sup> are still not available, due to political issues between entities. Also the lack of educated and trained experts disables the development of new model for BiH Pension System.

Another big problem which BiH has to face is significant emigration of workforce, which continued even in post war years toward developed western countries. According to Zwager and Gressmann (2009) study, the migrants from BiH belong to educated and most economically active cohort of population.

Important role of pension fund is to provide adequate living standard to elder. This function of Pension Fund is expressed via average pension benefit – net wage ratio. In Table 2 we can observe this ratio for BiH Pension Funds.

Table 2 – The ratio of average pension benefit and average salary in august 2015

August 2015	Republic of Srpska	Federation of Bosnia and Herzegovina
Average Pension Benefit (BAM)	342. 39	367. 14
Average net wage (BAM)	834	840
Pension benefit – net wage ratio	41%	43. 7%

We can see that pensioners in BiH enjoy approximately 42% of income that working population receive. When we take into consideration that average net wage in BiH is one of the lowest in Europe and that around 60% of pension benefit users receive minimal pension benefit we can conclude that pension benefit amount in BiH does not provide an adequate standard of living in older age. The elder people are the poorest part of population of BiH.

<sup>1</sup> The census of 2013 is the first census after prewar census of 1991

Although pension benefits are quite low and do not provide an adequate income for the old age, they in total amount do represent a big burden for both Pension Funds in BiH. Both Funds have finished previous year with loss, and were forced to take loans in order to pay out the pensions. Also, the budget transfers for big number of pensioners whose benefits are financed from budget are imposing a big pressure on Budget of RS and FBiH. Approximately 8,58% of budget of RS was transferred to Pension Fund in 2014 to cover for pension benefits.

Observing the data and projections<sup>1</sup> of both Pension Funds, it is quite easy to conclude that they are not sustainable, and that Pension Reform must move into direction of sustainability.

Nevertheless, the main role in organization and reform process of pension system has the political structure of the state. We strongly believe that in case of BiH, the political system is one of the main obstacles for Pension System Reform and improvement of sustainability.

Maybe the best example of inefficiency of Political System of BiH is the fact that Law that improves financial sustainability of Pension Fund has to be imposed by OHR.<sup>2</sup> The pension benefits increment and Pension Fund Reform have always been a pre-electoral promise of politicians. Unfortunately, Pension Fund Reform that would impose stricter conditions for retirement and made Pension Fund sustainable for long term would challenge a big resistance of citizens. Politicians with their short term horizon do not want to risk and lose votes because of unpopular measures.

This political situation actually often led the Pension reform in BiH in opposite direction. The pension fund continued to accumulate deficits, while pension benefits continued to increase because of politicians' interference,

To be precise, there is not one problem, but a great deal of them. Some of those are the unconcern of political structure, government inefficiency, bad Law implementation and in general whole system's bad functionality.

The Federal Pension Fund has not received a positive auditor's opinion since the Office for Budget Revision of FBiH has started to conduct revision in 2000. In every public auditor report there have been significant objections. In first years the objections were about wrong accounting treatments, non-implementation of Laws and Government Decrees, nonexistence of good system of internal control that would oversee the retirement process and its legality, but after the payment coefficient has finally started to be implemented the Political System has started to interfere. The Government has promised pension benefits under favorable conditions to some groups, but has not transferred funds from its budget for these pension payments. Likewise, The Federal Government has approved the unlawful payment coefficient increment. The Federal Government continued to raise pension payment coefficient since the pension growth has always been one of the pre-election promises, so amounts of Government debt have augmented and started to jeopardize the Fund's liquidity.

The fact that Federal Pension Fund had to claim its rights on budget transfer with a court suit in 2009 shows the shortness of horizon that politicians have regarding the sustainability of Pension Fund, the inefficiency of Government and non-implementation of Laws by Government itself.

The situation and the development trajectory of Pension System were similar in RS, too. The Laws of both entities were similar in its initial days, but with small differences in old age pension benefit requirements. The RS Pension Fund also had obeyed the Decision of Office of High Representative regarding harmonization of its pension benefit expenses with current revenues from contributions and budget transfers.

Evidence that should not be neglected comes from audits reports, where it is evident that this OHR Decree and Entity's Laws were not respected. The audit's opinions in period from 2001 until 2012 are or negative or given with reserve.

The unlawful usage of current revenues for foregone period's pension payment which is opposite not only to Pension Fund regulation, but also to Budget of RS Law is just one of these flaws, which is constantly repeated year after year. This

---

<sup>1</sup> The projections of both fund's future were done in two separate reform strategies documents, by Working Groups of each Government.

<sup>2</sup> The Office of High Representative in 2000 imposed the Decree which improved the sustainability of Pension System. The Decree on Amendment of the Law on Pension and Disability Insurance in FBiH, The Official Gazette of FBiH 49/00

practice, together with Government decision to increase the pensions and mismatch between expected and real budget transfers led to accumulation of Pension Fund deficits. The deficits were, again unlawfully, covered with short term loans.

The other significant shortcoming, according to audit's opinion, was the non-existence of effective internal control system that would prevent mistakes and misuse of Fund's resources and its official's authorizations.

Another issue that should be taken into consideration is that although auditors have year after year reported about unlawful actions regarding Pension Fund functioning, no one from responsible Government and Fund's officials was sanctioned or even called to give some explanations and responses regarding the situations. This stands for both entities, FBiH and RS.

Overall, the Pension Fund of RS is the subject of a big national debate. The Social and Pension System Reform is the one of the main pre-electoral promises of politicians. With their short horizon, politicians usually promise Pension Reform and higher pensions to current pensioners, economic growth and brighter future for all citizens, while the Bosnian and RS reality is a bit different. The pensions are increased under pressure of current pensioners who form a significant part of voters. On the last general elections 2014, the pensioners consisted 20.4% of total voters, so politicians did not want to take risk and lose their votes.

When we consider the political willingness for reform it is difficult to determine whether it is benevolent willingness to make a sustainable Pension System that would tend to meet the needs of current pensioners and workers (future pensioners), or the fact that BiH authorities are required by the conditions of credit arrangement with IMF to conduct fiscal system and pension system reform.

The one thing that is easy to determine is that there is not willingness or any conditions for Pension Funds merger. Although existence of two separate Pension Funds in a country as small as BiH is, their merger is out of debate and we will not discuss it further. There are still strong national tensions between three constitutive nationalities, and those tensions act in the direction of growing independence of entities, and it is sure that even mentioning of Pension Funds merger could just provoke these national tensions between Serbian nation on one side and Muslims and Croatians on another.

### **Pension System of Bosnia and Herzegovina perspectives**

The two main documents of state policy for Pension System Reform are The Proposal of Strategy for Pension System Reform in RS (2000) and The Strategy of Reform of Pension System in FBiH (2013). These documents were adopted by Governments of entities and the main guidelines for current Pension System improvement are stated to be:

Economic growth and development which will improve employment and worker's income

The inclusion of other population groups (except employed and self-employed) in pension system

The reduction of early retirement

Improvement of internal controls and fiscal discipline

The revision of disability pensions and war veterans pensions

The prolongation of insurance period and tightening of requirements for retirement

The above measures are the parametric reforms of current system, and some of them are so far included in the legislation and implemented. The more important reform direction is the reform of system itself. The Governments of BiH entities should consider the gradual transition<sup>1</sup> to fully funded pension funds and support the creation of voluntary pension plans<sup>2</sup>. The problem is that according to Strategies of Pension Reform of RS and FBiH, there are no basic fiscal conditions for

---

<sup>1</sup> The gradual transition is the only possibility for BiH pension funds since the transition costs are too high and could not be carried by the state budget at the moment

<sup>2</sup> The Law on Voluntary Pension Funds has been imposed in RS, but so far neither one Voluntary Pension Fund has been established.

even gradual transition to fully funded plans. Again, the role of the political system is crucial in defining the strategy and implementing it.

The author's view is that the role of life insurance (which market share is growing in recent years) should be analyzed and taken into consideration as the supplement of Voluntary Pension Funds. Also, the real estate of elder could have an important role in their social protection and providing the adequate living standards. The further researches are needed in this direction to analyze the workers population attitude toward new models and their influence on elder people standard and economy overall.

One of the most important public policies should be the definition of state pronatal policy. The need for this kind of state policy is not motivated just by pension system sustainability, but the sustainability of state itself. The elements of this policy could and should be incorporated in pension system to, in order to ease the pension contribution burden for families with children. As in the previous case, the further analysis is necessary to define the possible modes of this policy and their future implications.

### **Conclusion**

With this paper, we have tried to give our modest contribution to Pension System of Bosnia and Herzegovina debate. There is not a lot of research done in this field although it is of big importance for the economic policy of Bosnia and Herzegovina and each individual future too. So we hope that this piece of work will at least point out some problems and maybe indicate few new ideas for their overcoming and future research.

In the first part we gave a short description of BiH dual pension system and its legislation. In second part we shortly discussed main problems of BiH pension system, which previously have been identified by Government Strategies of Pension Reform. The biggest problem, under author's opinion is the political system interference in pension policy. The short horizon politicians are using pension policy to reach their own goals and win votes, while the pension system of BiH is sinking into debts. When accomplishing their objectives the politicians re neglecting the laws and audits report which are warning them on unlawful transactions and funding sources.

Still, the reform of pension system is stated to be one of the main objectives of Government, and some formal steps have been made toward its realization. But, as we stated above, when considering the political willingness for reform it is difficult to determine whether it is benevolent willingness to make a sustainable Pension System that would tend to meet the needs of current pensioners and workers (future pensioners), or the fact that BiH authorities are required by the conditions of credit arrangement with IMF to conduct fiscal system and pension system reform.

In the last part of the paper we gave a brief overlook of main reform guidelines already pointed out by Pension Reform Strategy Documents of both Governments. Also, the

### **References:**

Law on Pension and Disability Insurance in FBiH, The Official Gazette of FBiH 29/98, 32/01, 18/05, 73/05, 59/06, 73/06, 4/09

The Law about contributions, The Official Gazette of FBiH 35/98, 54/00, 16/01, 37/01, 1/02, 17/06, 19/08

The Law on Pension and Disability Insurance in Rs (The Official Gazette of RS 134/11)

The Law on amendment of Law on Pension and Disability Insurance in RS (The Official Gazette of RS 82/13)

The Law on contributions (The Official Gazette of RS 116/12)

The Law on Amendment of Law on Pension and Disability Insurance in Republic of Srpska, the Official Gazette of RS 82/13

The Decree of Government of RS on unscheduled harmonization of general point and pension benefits, The Official Gazette of RS 89/14

The Law on Pension and Disability Insurance in FBiH, The Official Gazette of FBiH 29/98



The Law on Pension and Disability Insurance in RS, The Official Gazette of RS 27/93

The Decree on Amendment of the Law on Pension and Disability Insurance in FBiH, The Official Gazette of FBiH 49/00

The Audit's Reports of Federal Pension and Disability Insurance Institute, reported by the Audit office for the Institutions of FBiH for years: 2001, 2002, 2003, 2004, 2005, 2006, 2008, 2010, 2011, 2012

The audit's reports of The Pension and Disability Insurance Fund of RS, reported by The Supreme Office for the Republic of Srpska Public Sector Auditing for years: 2001, 2002, 2003, 2004, 2007, 2008, 2009, 2010, 2012, 2013

Voluntary Pension Funds in RS: The Needs and Perspectives, The Working Group for development of Strategy for Pension System in Republic of Srpska Reform, 2008

The Amendment of Law on Income Tax, The Official Gazette of RS No. 120/08

The Proposal of Strategy for Pension System Reform in RS, The Government of Republic of Srpska, Banja Luka, 2010

The Strategy of Reform of Pension System in FBiH, The Government of FBiH, Sarajevo, 2013

The Law on Pension Reserve Fund of Republic of Srpska, the Official Gazette of Republic of Srpska No. 73/08, 50/10

De Zwager, N. & Gressmann, W. (2009) Maximising the Development Impact of Migration-related Financial Flows and Investment from Austria to Bosnia and Herzegovina. IASCI and IOM Report, prepared for OeEB.

Averting the old age crisis", (1994) A World Bank Policy Research Report, The Oxford University Press

Pensions et a Glance: Public Policies Across OECD Countries (2005), OECD

<http://www.ohr.int/>

<http://www.cbbh.ba/?id=1&lang=en>

<http://www.fzmiopio.ba/index.php?lang=ba>

<http://www.fondpiors.org/>

<http://www.saifbih.ba/default.aspx?langTag=bs-BA>

<http://www.gsr-rs.org/>

<http://www.pref.rs.ba/>