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# BOOK REVIEW

## “PENSIONS FOR 21ST CENTURY”

**Author:** Velimir Šonje  
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The pension system in modern society has several functions, the main ones being equal distribution of income of individuals and families throughout their lifetime, encouragement of individual and national savings, and the alleviation of poverty during old age and work inactivity. One of the most important goals of pension insurance is to maintain income of the elderly, and it seems that the programme has been quite successful in this regard. While the elderly were more often likely to belong to the relatively poor, today's indicators point to quite positive effects, that is, to a significant reduction in the poverty of the elderly.

In Croatia, until the beginning of the 2000s, there was only a public pension system of intergenerational solidarity and defined benefits. Therefore, expenses for current pensions were mainly financed from paid employee contributions. Such a pension system fell into a deep crisis because the existing paid contributions could not finance the costs of pension expenditures. This is why pension reforms were implemented, most notably the introduction of mandatory and voluntary capitalized pension insurance. The knowledge on the characteristics and complexities of the pension system in Croatia has been relatively limited.

It can be judged that the situation in this regard has changed significantly with the publication of the book *Pensions for the 21<sup>st</sup> century*, by the well-known author and economic analyst Velimir Šonje. Thanks to the financial support of the Raiffeisen pension fund, the book is available online for free. The book is a rearranged selection of a series of the author's texts that were published from spring 2021 to spring 2022 on the website arhivanalitika.hr.

In the brief introductory remarks, the author recalls that the extension of life expectancy is a civilizational success, but it still creates some serious difficulties related to higher allocations for pensions. He thoughtfully warns that possible panic when discussing pensions does not make sense, but one should think carefully and propose possible solutions to preserve the pension system. Šonje warns that he tried to provide knowledge in a simple and comprehensible way about important professional issues of pension insurance that are discussed in scientific publications and at round tables. However, probably due to the complexity of the topic, the general public is not sufficiently involved in it, and it can be judged that the majority of citizens are still insufficiently familiar with the observed topics.

The book consists of six chapters. In the first chapter, Šonje considers the effect of aging and long-term demographic and economic changes. At the same time, he shows how changes in the population structure affect the system of intergenerational solidarity (the first pillar) and how this system is fi-

nanced. Since the contributions are only sufficient to cover a little more than half of the pension expenses, the resulting shortfall is financed by transfers from the central state budget or by state borrowing on the domestic or foreign financial market. Thus, the pension system became one of the most important causes of a budget deficit of the central government, which accumulates over the years into public debt. Šonje explains it very vividly using the example of fictional countries and possible parliamentary debates on how to secure the necessary funds for pension expenditures. Politicians in both countries, averse to unpopular measures and unwilling to raise pension contribution rates, easily get into debt. Therefore, they shift the burden of their extravagance (or recklessness) to the young or even more often to the unborn generations, who, of course, are not represented by anyone nor can they participate in the vote. It seems that the repayment of the principal can be postponed indefinitely, but it is quite obvious that the time of political security and macroeconomic stability as well as cheap money for borrowing has passed. Therefore, it is necessary to think very carefully how to reconcile the irreconcilable: to ensure a decent retirement age and not to increase (or at least to do so as little as possible) the burden of pension contributions and borrowing. Although *small steps* such as technological progress, increased productivity and employment of elderly people who have retired are important and praiseworthy, they alone cannot solve the problem of pension adequacy. The situation can be somewhat improved by significant immigration of the population, but even that is not enough, some new measures are needed.

The necessary new measures are discussed in the second chapter titled *Pension systems: savings and investments*. Šonje points out that public pension insurance and individual savings are necessary because individual fully funded pension insurance is an important instrument that cannot replace the public pension system based on the principles of social security and intergenerational solidarity (p. 44). The author very nicely and comprehensibly explains how a 27% supplement is included in the pension, which until recently (2019) was only possible for people who were not insured in capitalized insurance, even though they paid pension contributions to the first pillar of intergenerational solidarity throughout their entire working life. Although it is a fairly obvious view that due to the aging of the

pension system the new generations finance to the greatest extent numerous older generations who are now retired (intergenerational redistribution), it is mostly ignored that in this system funds are redistributed from those who live shorter (mainly men) to people who live longer (women). At the same time, the importance of intragenerational redistribution from people who had relatively high salaries and worked long hours and therefore paid a large amount of pension contributions in total to those who earned little and worked for a short time, and therefore paid little, is almost always forgotten. While there is no maximum limit on salaries, there is a limit on the maximum amount to which contributions are paid as well as fairly strict provisions on the maximum pension amount. According to the provisions of the Law, the maximum pension is calculated by multiplying the total length of service by 3.8 value points and the starting factor, whereby it must not exceed two amounts of the maximum pension for 40 years of service. In any case, there are serious systemic errors in the system of intergenerational solidarity, so reforms were necessary to preserve pension insurance.

With the aforementioned reforms, the second pension pillar of capitalized fully funded pension insurance was adopted in Croatia, which is explained in more detail in the third chapter of the book. This form of insurance is often subject to (insufficiently argued and/or incorrect) criticism that the important role of insurance, which was traditionally performed by the state, is left to private initiative. Although investment liberalization was implemented in 2014 and different investment strategies are allowed for A, B or C pension fund categories that differ according to membership and principles, especially investment risk, the insured are mostly inactive and remain in medium-risk B funds. Therefore, Šonje correctly emphasizes that the insureds in the second pension pillar hold the keys to the allocation of funds and the relationship between risk and expected return in their hands through the choice of fund category, but they rarely use this option. A capitalized pension insurance system in shorter time periods can achieve weaker or even negative returns, but in a longer time period the returns are very good, and costs and fees are constantly decreasing. Of course, this does not mean that further regulatory improvements are not needed, especially since mandatory capitalized insurance pension funds have not left the Croatian

capital market, but due to their small size, they are actually turning into risk capital funds, for which the legal definition is not well adapted. The author is fully aware that the development of the Croatian capital market will not happen by itself, but in addition to improving the financial literacy and information of the insured persons, it will also be necessary to implement complex and decisive measures such as the abolition of the capital gains tax and some other activities.

The third pillar of voluntary capitalized pension insurance is the subject of the author's interest in the fourth chapter of the book, and he points out that this form of insurance is an opportunity that should not be missed. Šonje believes that there is a high level of complementarity between the third pillar of insurance and the first and second pillar, whereby incentives are intended to attract those savers into the system who want to save safely with returns that are comparable to returns in other forms of savings. Although around 400,000 people are now covered by this form of insurance, the average amount saved is quite small and is less than €3,000. At the same time, it should not be ignored that there are tax incentives for companies that pay pension savings to their employees or members, and there is no income tax on pensions from the third pillar.

In the fifth chapter, Šonje shows that the payment of a pension is not only a technical issue, but also has a great significance for the overall pension insurance. The author very clearly explains seven main topics related to pension payments, mostly related to the selection of a pension insurance company in

charge of paying pensions from personal capitalized savings and the complex decision of whether one should just return to receiving a pension from the public system of intergenerational solidarity. In 2021, slightly less than two-thirds of insured persons in the second pillar returned to the first, and only those who had higher salaries on average and saved more in the second pillar, which enables them to have a decent pension, remained. A possible mass return of insured persons to the first pillar means a dangerous future financial burden on the central government budget, from which transfers are allocated to cover total pension expenses.

The final sixth chapter contains proposals for improving the pension system. Šonje envisioned that chapter as a basis for a public debate on how to enable relatively generous and secure pension rights, without increasing at the same time the burden of public allocations and public debt that should be borne by future generations. Although it seems that there is no room and opportunities for significant improvements in pension insurance, Šonje presents a number of valuable and interesting, relatively simple proposals, whose acceptance could greatly improve the system. The author is deeply convinced that despite the aging of the population, the Croatian pension system can improve the living standards of pensioners while maintaining fiscal sustainability, but the system needs to be constantly adjusted and improved. In this, this book can be of great importance, especially in terms of opening a reasoned public debate and better informing the general public about the state and determinants of pension insurance in Croatia.

