


AN OVERVIEW OF VARIOUS PROBLEMS OF THE PENSION SYSTEM IN ALBANIA

Drita Luzo (Kllapi) 

“Eqrem Çabej” University, Gjirokastra, Albania

drita_kllapi@yahoo.com

Mirtila Llukani

Economist, Private Enterprise, Gjirokastra, Albania

mirtila.llukani@yahoo.com

Sotiraq Luzo

Portofolio Manager, NOA, Gjirokastra, Albania

s.luzo@gmail.com

Foti Llaka

Student of Economics, “Eqrem Çabej” University, Gjirokastra, Albania

fotillaka@yahoo.com

Abstract

A broad debate about reforming the pension system is being discussed in many countries. This reform should be designed in accordance with specific features political, economic and social situation in each country. Economy experts say that intervention in the pension scheme in Albania is necessary and urgent, not only because of the huge financial deficit, but also to avoid a deep social crisis. A major concern in the pension scheme is the age of retirement and the introduction of another column known as column zero, which will serve to those persons who are not involved in the scheme, to provide a lifestyle retirement through a pension benefit of social, say experts insurance scheme. In this article we will present an overview on the old pension system in Albania, as well as issues relevant to this system. We will work to talk about general information about the historical development of the pension system, the current

situation and the challenges and prospects for the future pension scheme. Pension system in Albania is organized under the PAYG principle. This system is not sufficient to achieve financial stability of the system and should be expanded in terms of private supplementary pensions. These funds have a special significance. At the end of the paper it is given a choice about pension reform in Albania, the new fiscal package including conclusions and recommendations following the idea that the pension system must be completely reformed.

Keywords: *Albania, Pension Scheme, Financing of the Scheme, Dependency Rate, Social Security, Pension Reform*

INTRODUCTION

"The honor of the nation begins with the elders and ends to the children" (Lincoln)

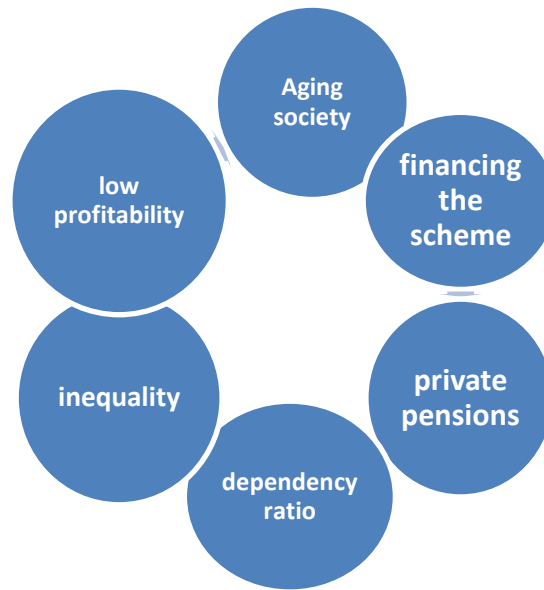
The word "pension" means a flow of payments for providing income that begin when an individual retires until the chain of life breaks. While the pension system is defined as a sketch or a set of pairs legal, monetary and financial conditions that establishes the rules and criteria for its functioning, where individuals of the elderly receive a payment that is the result of the contributions they have made on behalf of the state. Albania as many former communist regime faces numerous economic problems, social problems that hinder more and more the development of the country with the characteristics of a free and democratic economy. One of these problems is the pension system. Albania's process of changing from a centralized to a free market system and adopt the new system has had and continues to have difficulties. Many of these difficulties are compounded in decision making and implementation of various reforms in economic, social, political side. Although many reforms have been successful, reforms in the pension system have left much to be desired. One of the challenges facing the system is obviously the population also aging, which causes a disorder underlying the addiction rate. Demographic change brings into question the type of reform that should follow this system, parametric reforms, namely the continuation of the PAYG system or transition to a fully funded system (according to the World Bank proposals). Although the pension system in Albania has passed three important reforms in 1993, 2002 and 2005, these reforms are not enough to avoid a crisis in the coming years given the demographic trends of the population. The variant proposed by the World Bank, the introduction of multi-pillar system, applied in many European countries which have managed to avoid the problem of aging population, seems well suited for many more coming decades in our country. Our pension system is suffering from some acute problems that require relevant addressing.

First, the Albanian pension scheme is not considered sustainable because the contribution rate for employees is not enough to cover the needs for pension payments. Hysa (2013) in her study is expressed: social and financial sustainability of the pension system remains vulnerable. It suffers from a high deficit that makes it financially prohibitive. As a result each government team that has run the country in this time of transition is set with difficulties and is forced to accept the funding of the scheme by the state budget. In principle, this issue has to do with the conception of the scheme and socio-economic characteristics of the country. Secondly, the scheme provides lower benefits for some categories. The support the pension gives is not enough to live a fulfilled life with specific conditions and dignity. Pension amount for most beneficiaries is below the level to meet the basic needs of life. This is a problem that affects not only the pension scheme, but that the pension scheme is the main ingredient in the complex factors that cause this problem.

Thirdly, the scheme is characterized by emphasizing elements of injustice because some groups benefit too high contributions and contribute less than others. Furthermore, although all the elderly are covered by the scheme thanks to full employment under communism, a large part of the population of working age today is not insured due to high unemployment and also high informality at the same time. Unemployment is a factor that affects the pension system because an unemployed fails to shed his contributions. Informality is the aspect that undermines the proper functioning of the pension scheme, because someone who works illegally, fails to create sufficient fund contributions to support the retirement years. This has worsened the relationship between contributors and beneficiaries, and hints at the future too old will not manage to get a pension. In this way, the Albanian pension system is no longer able to balance adequacy of benefits to meet the expenses. Even more so when we consider the factor of population aging. Estimates for the population projections for the future show that the number of people in adulthood will be more and more increased compared with a fall farther and farther to the number of them at a young age. So, on the one hand we have less funding contributors to the scheme; on the other hand have more people who need to benefit from the pension.

Finally, it is evident that one of the ways how to solve the problems brought about by the pension scheme can be achieved gradually through the adoption and promotion of the use of private pension scheme. Pension funds, as already known, can be created by private and volunteer opportunities. But in our country this scheme, as a result of many factors, not yet recognized the right development and even fewer can claim a significant impact in addressing and solving the problem of sustainability of pensions. So, we can say that Albania's pension system faces the following challenges:

Figure 1: Illustration of some of the factors that interact with pensions

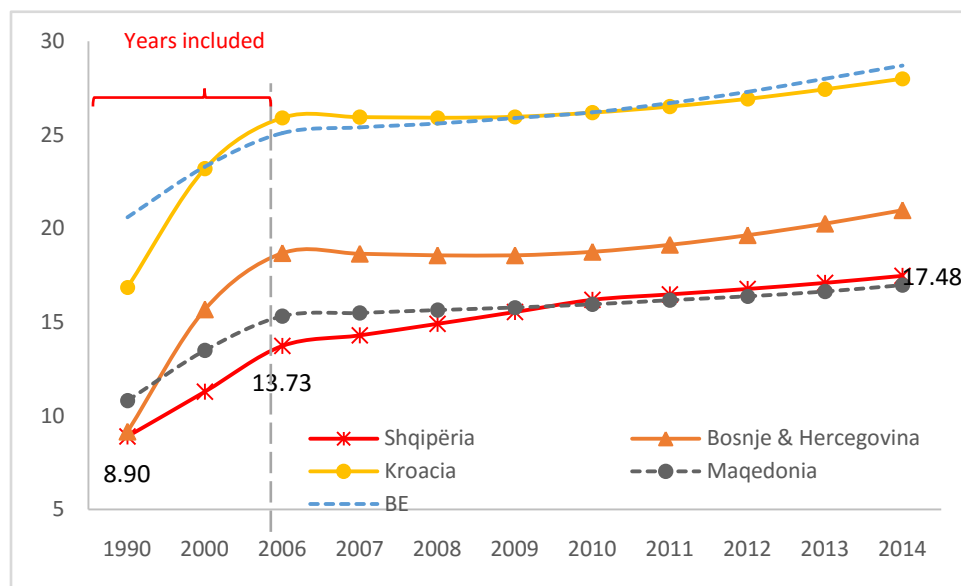


- The problem of financing the pension scheme,
- The problem of low profitability measure,
- The problem of inequality and fair redistribution
- The problem of contributions towards pension benefits,
- The problem of employment, informality and wage levels, related to social security,
- The problem of the aging society and
- The problem of embracing private pension

Albania, assessed as a country with a young population, has an indication of dependency ratio in old age population favorable when compared with other neighboring countries and beyond. Favorable in the sense that it results in lower levels compared with other countries. The illustration below helps to clarify this report. Initially we explain the chart gives the appearance of three periods: 1990-2000, 2000-2006 and 2006-2014 years she. In 2014 the dependency ratio of the population in age to Albania is 17:48, which means that we have about 17 people aged over 65 for every 100 people of working age. It is worth mentioning that the growth rate of this report is increasing in higher values. In conclusion, we can say that during the period 2006-2014 it is estimated an increase of 27% or deterioration. Compared with neighboring countries, Albania resembles more with Macedonia which reports similar values to those of our country, especially for the last period. Croatia is a Balkan country that has achieved the values of the European Union in this regard, where in 2014 this ratio stood at 28. The growth of this indicator translates into a problem for the pension system. This report goes hand in hand with addition

rate pension (contributory scheme for beneficiaries of the scheme) which shall address below. In recent years the ratio of contributors to beneficiaries addition as an indicator closely related to the problems of the pension system is further exacerbated by increasingly transmitting signals for intervention in the pension scheme. According to figures from the ISS to 2014, the dependency ratio is 1:12 contributors to beneficiaries. So around 1:12 people contribute through social security, 1 person benefits pension. This is very problematic for the economy because of this flow and many other implicated difficulties, such as the need and obligation to finance the scheme through the state budget for the remainder, without being covered by compulsory contributions; further we can mention that this low ratio implies either a high level of informality or large-scale of unemployment at a time when the labor force is considerable.

Figure 2: The Dependency Ratio of the Population in Old Age



Source: World Bank (2016)

Let's clarify pension funding problem in Albania. We recall how a pension fund is initially formed collected, a fund that is distributed to the beneficiaries account. First item of this fund is forced contribution, which is held on a monthly basis from the gross salary of each employee. This is the most important item of the pension fund in 2014 and has fallen by around 93% share of income from the pension scheme. Additional contribution is another component of the pension scheme, but its weight is very small in the total income from the scheme (only 7%). Taken together, the contribution of compulsory and supplementary are not enough to cover the obligations of the pension beneficiaries. To close the rest of pension, the state interferes with his budget. A small clarification needs to be taken into consideration. The fund actually comes from

the state budget as a subsidy known, but others may also consider it as "income out scheme". The measure of all the benefits of retirees recognized as a liability by the state to beneficiaries, represents pension expenses. Recognized obligations are financed. In normal conditions, when the pension scheme operates and conducts its goals, expenditures financed from revenues collected from newly collected contributions. However, due to many factors such income is not enough to cover all expenses for pensions. In these circumstances it is necessary finding another way of financing and this is funding through the state budget. Practically pensions financed by a source outside the scheme; So the money collected by taxation, instead of being used for the purpose of promoting economic growth, is lost in the coverage of "deficit" of the scheme. And the pension fund for distribution to beneficiaries is equal with:

$$\text{forced contribution} + \text{Additional contribution} + \text{income out scheme}$$

Figure 3: Illustration of the Formation of The Pension Fund

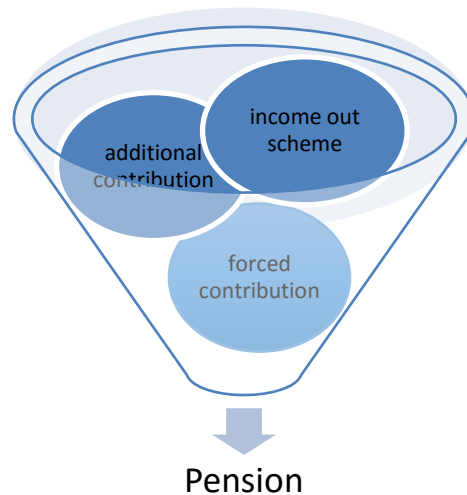
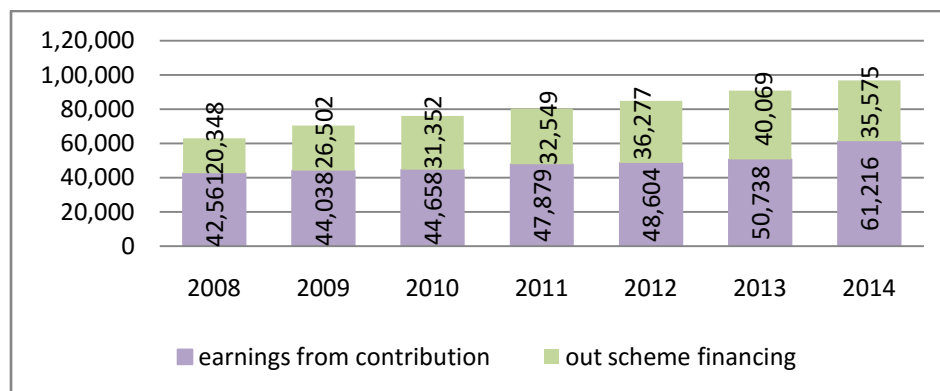


Figure 4: Pension Costs Generated as a Sum Between Income From Contributions and Outside Funding Scheme Over The Years



Source: ISSH (2016)

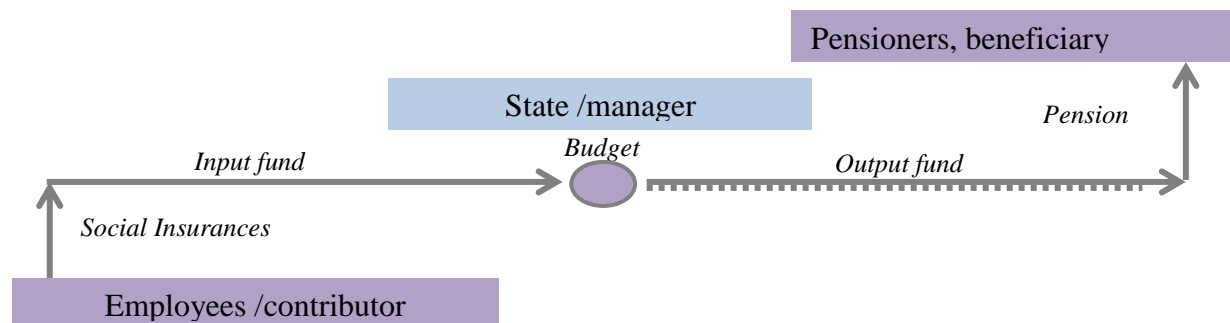
It is clear that over the years the level of expenditure on pensions is only increasing because, firstly, the number of beneficiaries increased from year to year and, secondly, the measures of individual pensions always are heightened to level the standard increasing life and to protect retirees from inflation.

For the year 2014 around 96.8 billion are carried, which is around 6 billion more compared to the previous year 2013. According to statistics from the ISSH from 2008 onwards part financed from the state budget is more than 30% of pension expenses. Only in 2014 the pension burden on the state budget calculated as 2.5% of the country's GDP. This is problematic for the scheme. When pension costs are not provided by the pension plan itself, then we are dealing with the volatility of the pension system; well pension scheme is not separate, it does not stay apart.

The undertaken reform of the pension system adopted in 2014, which launched its effect in January 2015, made a difference in terms of the contribution and the age of retirement. The main purpose of the reform was to expand the basis and amount of contributions. Social Security currently comprise 15% of the gross salary as a contribution by the employer and the employee 9.5%. Wages on which these contributions are applied are 22,000 Albanian Lek as a minimum wage and as a maximum 97.030 Albanian Lek.

All the dimensions that were submitted and reviewed above are those that address together and independently the issue of the pension system in Albania. The fact that we face with a lot of uncertainty about the sustainability of the pension system implies the need for a deeper study on this problem. In the below figure, the accessed amount that the state gives to maintain the pension scheme, is showed to the discontinued line, which together with the input fund from the social insurance complete the fund pension.

Figure 5: A Common Pension Scheme

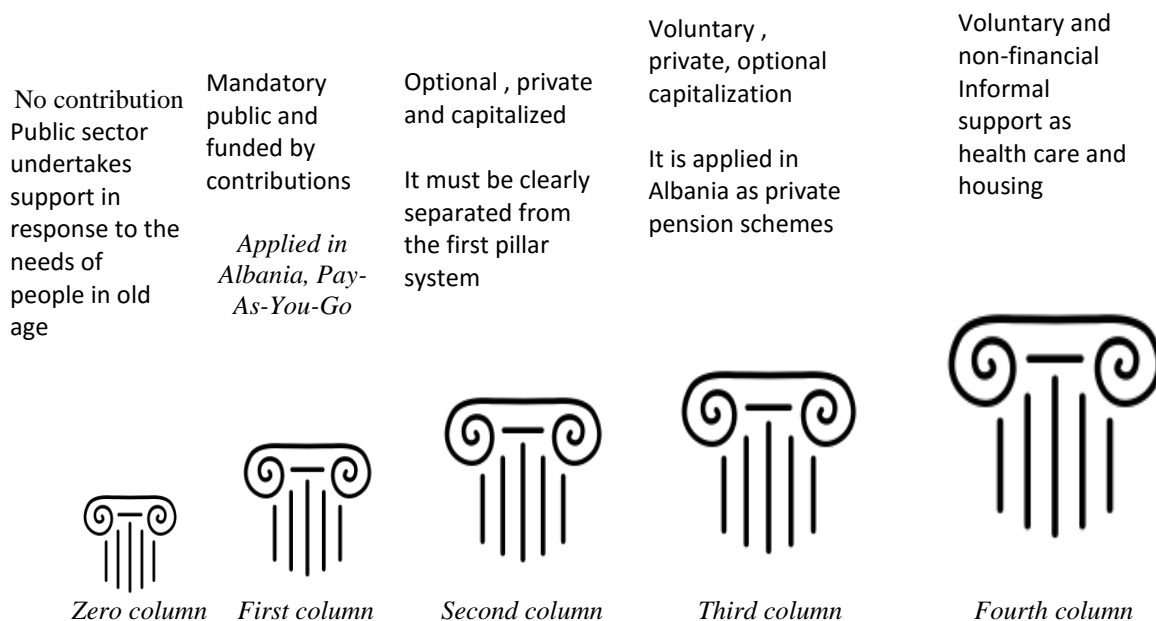


THE EVOLUTION OF SOCIAL INSURANCE AS A SOURCE OF PENSIONS

We begin the treatment with a brief history of the pension. As it is known, pensions are a product of social insurances. Social insurance is "food" of pensions, because pensions are financed by social insurances. By this virtue, it is natural to consider social security as a representative nature of pensions themselves. The book "The theory and practice of insurance" (Bundo & Lito 2014) played a special and irreplaceable role in terms of providing detailed information on the issue of pensions. On the other hand, Gjini (2013) and Hysa (2013) are of the rare albanians authors who have approached this subject and their work is very valuable in terms of the collection of movements that are made by different countries in terms of reforming social insurances systems, as well as analysing of the pension plan and their relationship with other factors and dimensions of the economy. Xhumari (2010) brings a very valuable comparative analysis of pension systems in the three countries of southeast Europe, including Albania.

Based on the literature of the field , there were considered five different columns of social insurances(for more see world bank (2008), " the world bank pension conceptual framework.

Figure 6: Illustration of Social Insurances Pillars



Source: World Bank (2008)

PENSION REFORM IN ALBANIA

Pension reforms in Albania have started since 1993 and there have been some. The fact that we have some reform in two decades shows in a way that all the efforts made have not led to a final solution of the problem of pensions in the country. Of course it is not only the responsibility of the professionals involved in this field, but also due to changes in conditions and economic and demographic circumstances.

Pension reforms' "Stations" are four. The first reforms to the pension system began in 1993. It was based on the unification of two different schemes of social insurances (of employees in state and cooperatives) to guarantee the same conditions for all individuals active in the work.

The second reform in 2002, intended to change the settings based on demographic forecasts. It was expected an increase in the dependency ratio of the elderly population.

The third reform of 2005 had to do with the adaptation of the social security system to a market economy, so it was given the possibility of privatization of the system.

Finally, the reform of 2014 or the fourth reform was a necessity. This reform aims to turn the pension system in a sustainable scheme, the development of the private pension market, financial market development, diversification of risk, better protection for citizens and diversification of social burden in the future. The way it is expected to be achieved is by increasing the retirement age and changes in contributions.

Table 1: Summary of Pension Reforms in Albania

Year	Reform	The aim of the reform	Special characteristics
2014	IV. Reform in parameters	A turn to a sustainable scheme, developing private pension market	Increasing the retirement age
2005	III. The private pension market	Adapting to market	The second and the third pensions column
2002	II. Reform in parameters	Facing with demographic social challenges	Increasing the retirement age and the reference salary
1993	I. Unification of the two social insurances schemes	A single system (application of the principle of social justice)	The beneficiaries, employees in the state and cooperatives

Source: Hysa (2013) and author's update

NEW FISCAL PACKAGE (2015)

The pension system has encountered problems in its operation in the country, according to a study by the World Bank to the pension system in Albania we mention (World Bank, 2014):

Ageing Population

The number of elderly people in Albania is expected to grow more than doubled, to 25% in 2050. In 2014, one in eight Albanians is over the age of 65, while in 2050 two in eight Albanians will be over this age.

The Shrinking of the Working Age Population

The working age population, which finances benefits for seniors, is gone. Albania is expected to have a contraction of the working age population from 14% in the period from 2010 to 2050, while there was an increase of 91% of the working age population from 1970 to 2010.

The Informal Labor Market

In Albania, only 35% of the working age population have paid contributions in 2012. It is anticipated that somewhere between 30% -50% of older people do not have pensions, compared to the period of study (2012-2014) when almost all seniors receive a pension. These problems, created the pension scheme changes, which are presented in the following issue.

The new fiscal package is created on the basis of intervention by the International Monetary Fund. The new fiscal package includes inside its 28 draft laws that are in force from 1 January 2015.

Pension calculation formula will be:

$$\underset{\text{pension}}{P} = \underset{\text{pension}}{PS} + \underset{\text{social}}{Sh}$$

- **P** is the amount of the monthly pension;
- **PS** is social pension , the amount of which is not greater than the mass of partial pension contributions achieved by the scheme ;
- **Sh** is extra part (additions), the value of which is 1 percent of the value of the assessment basis for each year, which represents the ratio of the average contributions in the current year with average contributions of previous years. So, the pension will be: social pension plus 1 per cent each year.

CONCLUSIONS

In conclusion we can say that the elements that differ from the new fiscal package are:

The Retirement Age for Women and Men

Regarding women, the increasing age has begun on January 1st of 2015 and will continue until 2056. This growth is expected to be 2 months each year. With the gradual increase it is projected that in 2056 a woman will be retiring at age 67. For men who currently retire at age 65, it is thought another plan for the gradual increase of the age of their retirement. From this year until 2032, for men, age pension benefit will not change any month. But in 2033, a man retiring at 65 years and 1 month. This scheme will continue until 2056, when a man must be 67 to obtain a retirement pension. So in 2056, the retirement age will be equalled for both men and women.

The Years of Contributions

Another change that comes from the pension system has to do with increasing years of contributions to social security. With the existing scheme 35 years of social security contributions is required for a full pension benefit. While the new scheme turns 40 years of contribution. This increase will be gradual, and is thought to be realized by 2025. There will be no partial pension or complete, while the minimum period to ensure the pension will be 15 years.

Report Contributor / Beneficiary

The Republic of Albania has 620 thousand contributors and 561 thousand beneficiaries and the ratio is 1 with 1. Raising the retirement age and the new scheme will change the ratio contributor/ beneficiary to 2 contributors per 1 beneficiary. This will cause the increase of contributions paid.

"Social" Pension

Social pension is a new concept for Albania. Social pension is conceived as a pension benefited only for all 70 years-people, not eligible for pension, only those people will benefit social charge. This pension will be applied to all those people who for the past 5 years have lived in Albania and income and living conditions in the Republic of Albania will be verified. The social pension will guarantee some minimum income but will not be so high as to replace the pension from the scheme.

Ceiling and Floor Pension

The new scheme sets a floor pension, which aims to provide a minimum subsistence, regardless of how much the contribution is. Limitation of existing maximum pension that is up to 2 times of the basic pension calculation is removed and it is also removed the calculation of 75 percent of the net salary. Regardless of how much the contribution is, the ceiling pension is removed.

Removing the ceiling of the maximum pension, is expected to reduce the contributory evasion. It is aimed of allowing individuals the opportunity to set their own pension amount that want to take advantage. In the new scheme, each year of work is known as 1 percent by which the assessable base is multiplied, this refers to real wages.

Pension Indexation

Coefficients of indexation will be used in the initial calculation of pensions. Coefficients can be considered as "interest factor" by which a salary in the previous economic conditions ranges in the present conditions and values. Pension indexation is made according to procedures and indexation coefficient estimated base of the respective year. To recalculate the pension estimated basis is recalculated . In addition to pensions, government indexes salaries every year for the pensions calculation effect. In the new scheme it will be calculated the maximum wage indexation to inflation. Clear and strict rules for pension indexation only to inflation will be set.

Changes in Supplementary Scheme

Public administration employees will have the same treatment as the current scheme. The retirement age for miners is lowered, but the age for MPs and ministers is increased. The retirement age for miners is defined 55 years, while supplementary pensions that benefit state officials and politicians, will be reviewed and their ages will run from 55 to 60 to 65 years.

REFERENCES

- AMF (2015). Tirana 2014. Supervision Report: Financial Supervisory Authority
- AMF (2015b). Standing Enterprise for Private pension schemes in Albania: survey analysis. Tirana: Financial Supervisory Authority.
- AMF (2015c). "Voluntary pension system in Albania - expansion of coverage." National Conference II. October 8, 2015, Tirana.
- Atkinson, A.B. (1987): Income maintenance and social insurance in Auerbach and Feldstein (eds), Handbook of public economics. Netherlands.
- Bagwell, K. and B.D. Bernheim (1988): Is everything neutral? Journal of Political Economy 96, 308-338.

Bakvis, Peter (2005). "Social Security Systems and the Neo-Liberal Challenge". ICFTU / Global Unions - Washington Office.

The World Bank Pension Conceptual Framework:

Barro, R. (1978): The Impact of Social Security on Saving Private. American Enterprise Institute for Public Policy Research. Washington D.C.

Becker, Uwe (2007). The Scandinavian Model: Still an Example for Europe?

Bentzel, R. and L. Berg (1983): "The role of demographic Factors as a determinant of saving in Sweden" in Modigliani and Hemming (eds.): The determinants of National Saving and Wealth. London: Macmillan.

Bernheim, B.D. (1987a): The 'economic effects of social security: toward a Reconciliation of theory and measurement. Journal of Public Economics 33, 273-304.

Boskin, M. and M. Hurd (1978): The effect of social security on early retirement. Journal of Public Economics 10, 361-377.

Bovenberg, Lans and Casper van Ewijk (2011). The future of multi-pillar pension systems. Browning, M.J. (1982): Savings and pensions: Some UK evidence. Economic Journal 92, 954-963.

Ebbinghaus, Bernhard. The Privatization and marketization of Pensions in Europe: A Double transformation Facing the Crisis. Universiteti of Mannheim. Germany.

Englantina Hysa (2013). Social Security in Albania: the impact of demographic change on individual choices. Dissertation: Faculty of Economics, University of Tirana.

Euro Stat (2007). Pensions Schemes and Projection Models in EU-25 Member States. European Economy, Occasional Papers by The Economic Policy Committee and Directorate-General for Economic and Financial affairs.

Social Security Institute. (1993). Law no. 7703 "On Social Insurance in the Republic of Albania". Tirana.

Xhumari, Merita (2010). Pension trajectories in the Western Balkans. Comparative study of three cases: Albania, Macedonia and Kosovo 1990-2010. Dissertation.