




REVIEW OF THEORETICAL AND EMPIRICAL LITERATURE ON THE PENSION SYSTEM - ALBANIAN CASE

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Abstract

Albania's pension system faces many challenges and many problems to be addressed. In 2018 the next reform was undertaken in order to facilitate pension scheme. The literature of the field is not consolidated in the case of Albania, which is mainly due to the short history of poor management and statistics of interest. Foreign literature is a great source where the consultation mainly to reform schools and various social protection is founded. The study aims to shed light on the literature review, theoretical and empirical one and to see which one is the most suited for our pension system in the future. Empirical studies of pension behavior must meet specific characteristics and take into account the social security system. This is an evident fact in most of the studies considered. Most studies underestimate the partial retirement and reintegration into the labor market, losing important aspects of the labor market for older people. Another problem that can be important is that risk and uncertainty is a factor that has not been taken into account (ignored).

Keywords: Pension system, sustainability, income from the scheme, funding from the state budget, uniformity

INTRODUCTION

The process of transition in Albania from the centralized system to the free market system and the adoption in the new system has had and still continues to have great difficulties. Many of these difficulties consist in decision-making and implementation of various reforms in the economic, social, political, etc. fields. Although many reforms have been successful, reforms in the pension system have left much to be desired. One of the challenges that this system must undoubtedly face is the aging of the population, which causes a pronounced disorder in the rate of addition. Demographic change brings into question the type of reform that this system should follow, parametric reforms, so: the continuation of the PAYG system or the transition to a fully funded system (according to the proposals of the World Bank, 2008, 2015).

Although the pension system in Albania has undergone three important reforms, in 1993, 2002 and 2005, these reforms are not enough to avoid a crisis in the coming years given the demographic trend of the population. The variant proposed by the World Bank, the introduction of the multi-column system, applied in many European countries which have managed to avoid the problem of population aging, seems appropriate for many decades to come.

In Albania, the pension system is suffering from some acute problems, which require appropriate addressing. The pension system in Albania faces several challenges such as: The problem of financing the pension scheme, the low benefit rate, contribution ratio for pension beneficiaries, aging society and the problem of employment, informality and wage level related to social security.

Purpose of the Study

The purpose of this paper is to conduct a detailed analysis of pension systems focusing on the review of the pension literature theoretical and empirical one and choosing the best possible model for our country, Albania.

LITERATURE REVIEW

Many authors and researchers have contributed to pensions as a means of providing and supporting the elderly. To summarize these contributions it is appropriate to elaborate on this approach according to its origins: social security, a brief history on the evolution of social security and pensions in particular. Thus, a review of the theoretical and empirical literature related to the issue of pensions also brings an exposition of the most prominent contributions in the field of pensions by both foreign authors and Albanian scholars.

As it is mentioned, pensions are a product of social security. Social security finances pensions. Relying on this connection it is natural to consider social security as a representative nature of the pensions themselves.

The book "Insurance Theory and Practice" (Bundo & Lito 2014) has played a special and irreplaceable role in terms of condensation of literature materials for consultation.

On the other hand, Gjini (2013) and Hysa (2013) are among the rare Albanian authors who have approached this topic and their work is very valuable in terms of summarizing the movements that have been made by different countries in terms of reform of social security systems, as well as in the plan of analysis of pensions and their connection with other factors and dimensions of the economy.

Xhumari (2010) brings a very valuable comparative analysis of pension systems in three Southeast European countries, including Albania. These are the most famous Albanian authors who are dedicated to our field of study.

Among foreign scholars, a very interesting discussion brings Peter Bakvis (2005) in "Social Security Systems and the Neo-Liberal Challenge". Bakvis tries to present the challenge that social security schemes have to meet the standards adopted by the World Labor Organization.

According to the German researcher Ebbinghaus, his full discussion in "The Privatization and Marketization of Pensions in Europe: A Double Transformation Facing the Crisis", presents the adjustments that have been made in the field of pensions in European countries, which have taken into account the privatization side. and that of market orientation (marketing).

Also, Williamson et. al. (2006) has contributed to the creation of an exposition of the history on the insurance system in Russia. Russia currently implements the pay-as-you-go (PAYG) model supported by the World Bank as well as our country, Albania.

Nazarov and Murylev (2012), present the problems of the Russian social security system by grouping them into two dimensions: the problem of population age and the problem of financing the scheme.

Markowski and Palmer (1979) estimated a function of aggregate savings for Sweden, including as regressors time-delay savings, income and inflation.

Feldstein and Pellechio (1979) began their theoretical discussion by assuming that total wealth (including social security wealth) is proportional to net income from last year's work.

Unlike the studies discussed so far, Manger (1986) applies a consumer function approach to test the effects of the social security rate.

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this approach according to its origin: social security. Thus, a review of the theoretical and empirical literature on the issue of pensions, also brings an exposition of the most prominent contributions in the field of pensions by both foreign authors and Albanian researchers.

In its infancy, social security schemes took on a materialized appearance around 1820-1830. The main forms of social security offered and guaranteed in this period were three:

- Care for the poor, with a level of income and living conditions below a certain limit.
- Comprehensive assistance for groups of workers, such as working conditions and income guarantees in case of loss of ability to work or accidents at work, or due to work.
- Private insurance allowed by law and the responsibility of the state to guarantee respect for rights.

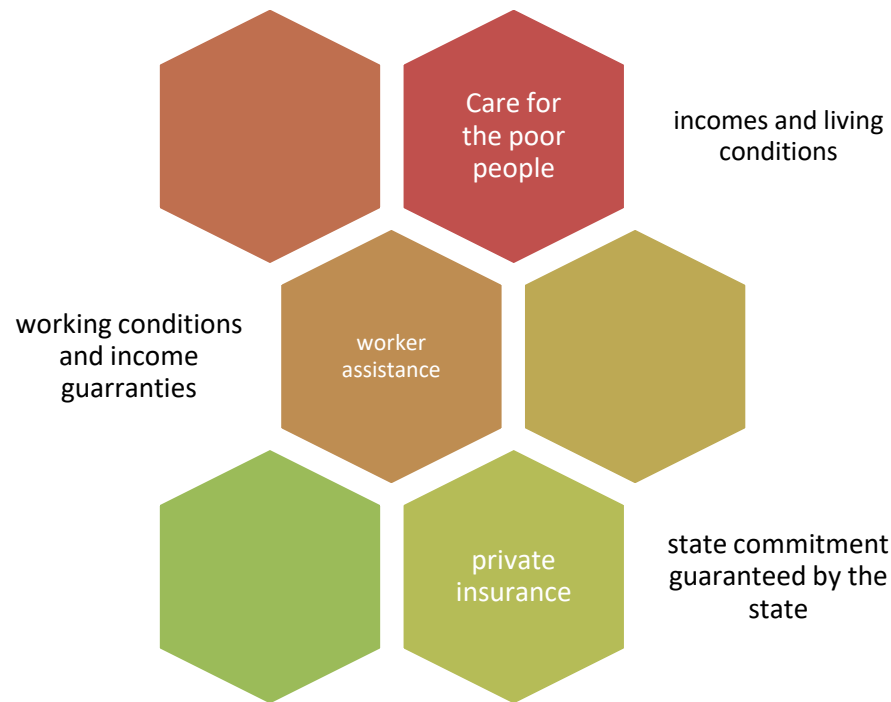


Figure 1. Illustration of the first forms of social security schemes

The three main forms of social security have outlined three relatively different models in the features of social security, which are conveyed to this day as specifics of economic models and well-diversified European social life. Caring for the poor has been the **first form**, the basis of economic and social development in the UK and the Scandinavian countries. Under the model and form of care for the poor, in the United Kingdom (mainly in England), the state system of social care and support was established. The first achievement and guarantee of this scheme was the provision of a pension for the elderly, and long-term assistance. After

World War II, state social support was replaced by extensive and compulsory insurance for all citizens.

The second form has been typical mainly for Central Europe. In Central European countries, workers' mutual aid movements were created for each other, schemes which were initially under state control. Later they were made with the support of the state. This form led to the creation of the first social security schemes. The first reform in this form belonged to the state of German Chancellor Bismarck, and was subsequently carried out around 1880, also by the Austro-Hungarian Chancellor Taaffe.

The third form, as guaranteed private legal insurance, has its origins in the years 1817-1830, the foundations of social insurance were established, as genuine schemes, based on the probability of occurrence of the event and the data provided by the elaborated tables of longevity and mortality.

Social security, for workers, as a group, for each individual of the collective, as a guarantee for the whole collective, for the first time, and in mass and wide form, was established in Germany, in 1883.

It is clear that the functioning of such systems can not be achieved without the existence and reliance on some basic principles. Social security systems, despite the differences and differences in the technique of implementation from one country to another, essentially take into account the fanatical application of certain principles that make up the content of the basic systems. These principles are:

- **Principle of inclusion** - Basic systems are systems that extend to the entire permanent population of a country. They are provided with a basic unit of benefits and assistance, in accordance with the fulfillment of legal requirements, or in accordance with the social difficulties they face. Thus, the pension benefit is achieved when certain conditions are met such as retirement age, seniority at work, the obligation to have paid the mandatory contribution, etc. Basic systems respond to the reasonable demands and needs of the individual to cope with the risks and difficulties of living. Nevertheless, scheme participants are not prevented from taking advantage of other opportunities offered by the economy or the community. Thus a contributor to the basic insurance scheme can invest in a private pension fund.

- **Uniformity and equality** - Participants in the insurance scheme are treated by a way of support and the same calculation formula. Equality is not in its purest sense, but in economic terms, where each member is treated as far as they belong within the quadrant of the insurance system.

- **Complexity and sufficiency** - insurance and pension schemes have changed over the years, becoming more complex. It is closely related to employment and the amount of contributions. Pension schemes, on the other hand, are built to have an internal balance, a mechanism that meets the needs they face.
- **Guarantee** - basic insurance schemes are guaranteed by the state through legal and economic mechanisms. Especially in the case of mandatory schemes, the state participates not only in terms of legal regulation of the system but also as an actor in the administration and guarantee of the functioning of the pension scheme. In the case of Albania, the government is obliged to finance a part of the pensions through the state budget, thus playing the role of guarantor for the scheme functioning.

EMPIRICAL LITERATURE

Concentration Of Literature By Fields.

Theoretical Effects Of Pensions

This section provides a theoretical discussion of the main effects of the relationship between public pensions and personal savings. The discussion framework is a simple model of overlapping generations, a model where each generation acts as a life cycle consumer. This model is also known as the simple model of overlapping generations of two periods. The effects of pensions are analyzed using the pay-as-you-go (PAYG) pension scheme, where pension benefits are currently financed by taxes. An alternative way of financing pensions is the full financing system, where each generation finances its own pension. Theoretically a full funding system would not deviate much from a situation without public pension schemes. Besides the **PAYG scheme** is the most used system in western economies.

The effects of PAYG savings pensions depend heavily on assumptions made about the environment in which consumers operate, for example the capital market, and consumer behavior, for example the specification of utility functions. Here are analyzed in particular three main assumptions that have been frequently discussed and which have also been tested in many empirical studies. First, it discusses how pensions affect retirement behavior and job supply. Then comes the income from work and the role of inheritance.

Generation overlock model

Generational overlap models have been used to analyze how intergenerational transfers affect economic growth. The first model of its kind was introduced by Samuelson (1958). Diamond (1965) introduced this model in a neoclassical production environment, which is then

expanded by Barro (1974) to discuss the effects of altruistic inheritance within the same logical framework. In models with two periods income from work is assumed to be taken only in the first period. Here is a simple model of overlapping generations without production, where labor income is obtained in both periods. This is useful when analyzing the effects of uncertainty and a similar model has been used by Feldstein (1988).

The economy consists of two overlapping generations of identical individuals. Each generation lives for two periods, has no initial assets, but receives income from work in two periods. The retirement age is assumed to be fixed and occurs in the second period. Donations and uncertainty are not included at this stage, but will be introduced later.

The rest of this issue will discuss the effects of using the pay-as-you-go (PAYG) scheme on this model. Already, most Western economies use such schemes, so a more appropriate discussion would be to analyze marginal changes in the existing pension scheme. From an empirical point of view, this distinction is significant.

Transfers between generations

So far we have ruled out endogenous intergenerational transfers in the model. However there is no doubt that transfers occur as inheritance, as education or donation costs. Analyses have shown that intergenerational transfers matter (Kotlikoff and Summers, 1981; Bernheim, 1991), and should therefore be considered when analyzing the effects of old-age pensions.

Barro (1974), argues in favor of a simple altruistic motive of inheritance. This can be represented by the use of next generation benefits in the current generation utility function (1) and means that all generations are linked together in a dynamic framework. The function of utility is,

$$(1'') U_t = U(C_t, 1, C_t, 2, U_{t+1})$$

In the end, consumption remains unchanged for all generations as the available resources are the same as before, when the pension scheme was introduced. It should be noted that this result is valid only for marginal changes in the pension scheme and the inheritance must be operational before the change occurs (Internal Settlement), as Barro (1974) puts it. Many theoretical arguments have been presented in order to Barro neutral score is avoided, such as the Feldstein (1976), Tobin and Butler (1980) and Bernheim (1987).

A more important critique of the Ricardian equivalent score is given by Bagwell and Bernheim (1988). They facilitate the assumption of representative agents and analyze the

implications of inter-family ties (through marriage between unrelated individuals). In this case "everything" is neutral. Since this is far from what has been observed, they argue that the conclusions followed by the Ricardian equivalence are questionable.

Feldstein (1974) is an important contributor to the literature for two main reasons. First, he introduced the study of the importance of social security in relation to personal savings to the research agenda. Only a few earlier analyzes raised this question and their results were contradictory: a finding claimed that social security could lead to increased savings. Second: Feldstein began research into behavior at retirement age.

Markowski and Palmer (1979) estimated a function of aggregate savings for Sweden, including as regressors, time latency of savings, income and inflation.

For Canada, two studies are briefly discussed. Boyle and Murray (1979) evaluate the function of consumption and savings as in Fieldstein (1974) and Munnell (1974) respectively, in the period 1946-69. The effects of 5 different social security rates were assessed, but none showed a significant impact on consumption.

Lee and Chao (1988) evaluate the job offer between retirees and personal savings, separately using data obtained from Leimer and Lesnoy (1982). Both equation models make it possible to control the effect of retirement and find net effect of social security on personal savings.

Two Feldstein studies, which use the median time technique, show a negative impact on savings, while Barro and MacDonald (1979) and Koskela and Viren (1983) favor the opposite impact based on another evaluation procedure. Although it seems that the conclusions are determined by the evaluation method, comparisons between different studies show that other differences are also important.

In continuation, the results of Feldstein (1980) and Barro and MacDonald (1979) can be carefully compared. The conclusion is that all the different factors contribute, more or less, to the differences in results such as in model specification, model between countries, definitions of variables, data sources and evaluation period. Koskela and Viren (1983) comparing their results with Feldstein (1980) argue that the calculation of social security contributions is an important factor. They replicated Feldstein's estimates by arguing that this situation is taken into account only when the benefit variable is divided by the population from which a given coefficient is taken. However, it is attractive to argue in favor of Feldstein's results as he uses a measure of expected benefits instead of actual benefits, and the first measure should be more important given a small portion of the population. Modigliani and Sterling (1983) confirm the results in Feldstein (1980), as long as it has a direct effect on savings, including more places in the data set. The reason why they fail to

find an overall negative effect on savings is the large effect of social security benefits on the employment rate for retirees. In particular this effect is stronger than that predicted by Feldstein (1980). The difficulty lies in comparing the effects of the participation rate, as both the specifications and the definition of the data are different in the two studies. Modigliani and Sterling suggest that the difference in results depends on the countries involved and the different evaluation periods. So even if some factors support Feldstein's analysis, the main conclusion is still unclear due to the findings by Modigliani and Sterling (1983).

Kotlikoff (1979) estimates a link to a sample of 2124 American male heads of households who were between 45 and 59 years old in 1966.

According to Feldstein (1983) an asset equation is estimated for 2087 married couples aged 58-63. Age variables for both men and women are, in addition to the social security rate and income size, included in an asset equation. Current income-related income over a lifetime is included in the income model over time. Estimates are made with and without a quadratic income term. Since this term is important in almost every equation evaluated, those equations that include this term are taken into account. In an OLS regression, the social security rate is significant and the coefficient is calculated to be -0.35. By checking in the calculations for possible revenue measurement errors over the life cycle, the estimated effect increases to -0.42. Feldstein also combines heteroskedasticity correction with two different control methods. With one of the control procedures, the estimated coefficient was changed to -0.72 with standard error 0.58. With the other method, which does not rule out bias, the coefficient is -0.03 with a standard error of 0.46. Against this background the analysis provides support for a negative saving effect for a pre-retirement group.

In a related study, Blinder, Gordon, and Wise (1983) use the same data source as Feldstein (but observations from 1971 rather than 1969) for 4,130 white American men aged 60-65.

Feldstein (1983), Blinder, Gordon and Wise (1983) and Bernheim (1987) all use data from retirement history (LRHS). Based on the previous discussions of each study, we have shown that studies based on this data source are divided on the question of whether there is a downward effect of social security on the accumulation of funds for a group of non-retired individuals.

The results from Blinder, Gordon, and Wise appear more reliable than those of Feldstein (1983), according to the data improvement. On the other hand, if the suggested Bernheim method is important, we should pay less attention to the results achieved compared

to the other two studies; Manger (1986) and Feldstein and Pellechio (1979) are both based on different samples from the Consumer Financial Characteristics Survey, conducted by the Federal Reserve Board in 1963 and 1964. The conclusions in these analyzes support a negative effect from insurance social in personal savings for a group of non-retired individuals. Two studies by King and Dicks-Mireaux are based on the same Canadian data set, which found a negative effect on aggregate accumulations. Kotlikoff (1979), found a negative substitution effect, using the national survey data of 1966. The total negative effect on savings by Leimer and Richardson (1992) is based on data from the 1982-83 consumer spending survey. Kurz (1984) uses data from a study undertaken by the Presidential Pension Policy Commission and finds supporting evidence in two hypotheses: the life cycle hypothesis and the intergenerational hypothesis by dividing the data by head of household. The study by David and Menchik (1985) is based on data from Wisconsin and rejects a substitution effect on savings.

Studies with panel data

Diamond and Hausman (1984) is the only single-site data-driven study. The data cover the period 1966-76 and during this period significant changes were made in the American social security system. The main advantage in panel data over cross-section data is the ability to incorporate some current changes to the social security system over time. More importance should be given to this study than to cross-section study. Interestingly in this study is that the social security rate has a major impact on behavior at retirement age. There are also indications of declining total wealth after retirement, which is in line with life cycle theory.

Based on this analysis, social security benefits decrease by 12% with the accumulation of wealth after retirement. The authors also estimate savings equations and discover how expected benefits from private pensions and those from social security both lead to savings reductions. One percent increase in expected social security benefits related to permanent income reduces savings in year by 0.14%. Assuming the number of expected years of accumulation and the number of expected years of retirement, as well as the tax interest rate, it is estimated that the overall effect of compensation is in the range of 0.25-0.4 percent. This is a significantly lower effect than that of the cross-section study by Kotlikoff (1979), but consistent with the results of King and Dicks-Mireaux (1982), Feldstein (1983) and Leimer and Richardson (1992)

CONCLUSIONS

Table 1. Summary of basic literature consulted

AUTHORS	METHODS	VARIABLES	CONCLUSION
Gjini (2013)	Regression models (not based on literature)	Macroeconomic factors: GDP growth, Population aged 20-64, Population over 65, Contributions to GDP, Inflation, Unemployment and Labor Force	Confirms that the pension scheme (that of 2013) results in a deficit in the future if the basis of contributions does not change. The development of private pension funds in the form of the second and third pillars should be encouraged. The possibility of replacing the rural scheme with a mandatory pillar with defined contributions should be considered.
Hysa (2013)	Life cycle model; General equilibrium model: simulations	Simulations	The level of savings is at lower levels if a publicly funded system is applied compared to the case of the private funded system.
Kowalewski (2012)	Model panel, regress	Microeconomic variables of the accounting and financial field of pension corporations	Government mechanisms related to pension plans are weak
Levasseur (2011)	General equilibrium model: simulations	Simulations	Treats the risk of instability and bankruptcy of the pension scheme
Novy-Marx dhe Rauh (2010)	Novy-Marx and Rauh Cash Flow Model (2010)	State obligations for pensions to employees; Amortization rate of flows according to the perspective of taxpayers; Return of treasury bills	Recognized liabilities change if we apply different fund discount rates. Pension liabilities are even higher if you consider the salary increase and the contribution of this increase to the discount rate.
Rauh, J. (2010)	Novy-Marx and Rauh cash flow model	“”	The pension model analyzed by Rauh (California, USA) is volatile given that state liabilities will continue to increase.
Samuelson (1958); Diamond (1965); Barro (1974); Feldstein (1988); Deaton (1992); Leland (1968); Kotlikoff dhe Summers (1981);	Empirical model of generational overlap	Key factors: income from work and other factors are: retirement age; donations and uncertainty;	Using the PAYG pension scheme will normally reduce the level of personal savings. Intergenerational transfers matter. When the labor supply is allowed to be freely changed by the consumer, this

Bernheim (1991); Tobin dhe Butler (1980) etj.		savings; taxes; benefit etc.	conclusion is no longer clear (in part) as long as the increase in consumption can be replaced by leisure.
Feldstein (1974); Munell (1974); Barro (1978) Darby (1979); Modigliani dhe Hemming (1983); Analizë empirike e serive kohore Leimer dhe Lesnoy (1982); Markowski dhe Palmer (1979); Lee dhe Chao (1988); Magnussen	Empirical analysis of time series	""	Most time series analyze report that there are no effects on consumption and savings, but this may be due to collinearity problems
Barro dhe MacDonald (1979); Koskela dhe Viren (1983); Koskela dhe Viren (1983); Modigliani dhe Sterling (1983); Feldstein (1980); Kurz (1984) etj.	Empirical spatial analysis between countries	""	They find no evidence for negative effects on savings, although these analyzes are not convincing because the results differ significantly between studies conducted. The spatial analysis found a negative effect on savings or accumulated wealth for population groups in the vicinity of retirement.
Diamond dhe Hausman (1984); Kotlikoff (1979), King dhe Dicks-Mireaux (1982), Feldstein (1983) dhe Leimer dhe Richardson (1992)	Panel data	""	They find no evidence of adverse effects on savings, although these analyzes are not convincing because the results vary considerably between studies conducted.
Blinder, Gordon dhe Wise (1980); Kahn (1988)	Empirical model	Opposite effects of social security	""
Cobbaut (2014) dhe Quintart(2015)	Risk management	Micro and macroeconomic factor	""
	Empirical models: structural; assessment of risk functions; of reduced form	Estimated effects of retirement and job supply	Social security affects the job offer of people over a retirement age. Since the benefits depend on the median income before retirement, the potential benefits normally increase with the retirement deferral. Uncertainty is a factor that has not been taken into account.

Gannon et. al. (2014) addresses the stability of the first pillar for the insurance system in France. To achieve this aim they address two methods (a) the automatic balancing mechanism based on the tax gap and (b) the smoothed automatic balancing mechanism. They use simulation models to arrive at a response to the sustainability of the first pillar of social security. The variables considered are macroeconomic.

The results of the study emphasize that sustainability requires reductions in pensions and an increase in the contribution rate

Schmidt-Hebbel (1999) approached the hypothesis that pensions have implications for productivity, savings, and economic growth. The author has managed to make a summary of the contributions of other scholars who have been devoted to this field. Such an analysis requires a structural empirical approach. The empirical models that have been considered are of the form that seek to capture the impact of the pension system on the structural factors of the economy. According to Schmidt-Hebbel, the pension system improves the factor of productivity, savings and economic growth. The author even says that about a quarter of economic growth can be attributed to the contribution of pension reform.

Regarding the reform of the pension system as well as the "liberation" of the state budget from the burden of the pension scheme, the author says that the process of passing the pension scheme to the private format is something necessary.

Pension reform should be seen as a necessary key component of an overall effort in implementing a market-based and private sector-based strategy that allows the public sector to focus on correcting outreach and combating poverty. Schmidt-Hebbel (1999: p. 29)

Based on the treatment of the field literature and the researchers' considerations of the phenomenon, two main hypotheses will be deduced, which will answer the questions: Does the pension system support economic growth? How sustainable is the pension system in our country? These hypotheses combine four different components: income from the pension scheme, pension expenditures, out-of-scheme financing and economic growth. The model which will be used in the study to verify the first hypothesis is a multifactorial linear econometric model.

Studying the stability of variables is a challenge in itself. However, such empirical approaches have been formulated to provide answers to these questions as well. One of the most popular and used methods is that of unit root. This method has also been used by Albanian researchers to show whether macroeconomic factors are stable or not (for more see Tanku et al. 2009). The future research shall be an empirical study of pension system in Albania.

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