



RETIREMENT FUND SYSTEM REFORM IN ALBANIA: ISSUES AND CHALLENGES

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Abstract *The process of developing the social insurance system in Albania corresponds to its transformation from a centrally planned to free market economy. In the center of the social insurance system is the retirement fund scheme. How successful is the Albanian pension system to fulfill its functions? This paper through a descriptive analysis of the current pension system in Albania identifies issues and challenges for the development of a sustainable pension system in the context of socio-economic development of the country. The paper presents the suggestions to improve the pension situation in Albania.*

Key words:

Reform, pension system, contributors, beneficiaries

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1. Introduction

Pension systems are designed to provide income for those individuals who suffer a loss of earnings capacity as a result of old age, disability or death of breadwinner. In some cases, systems are designed to facilitate direct transfers from the government to these groups and can be evaluated as such, but, in most of the cases, the emphasis is on providing a mechanism through which the individual can ensure himself against the loss of income in the future (Schwarz, 2006). In general, pension systems consist of three basic functions: - First, the pension system includes a preventive function which should guarantee the same standard of living as during the employment even after retirement for the retired people. Otherwise, people in their pension age do not have the necessary funds to maintain the same level of wealth for themselves and their families (ECLAC, 2006). - Secondly, the pension system has an auxiliary character: he strives to alleviate poverty (Barr and Diamond, 2008). This feature includes financial support to people unable to work due to age or disability. A minimum amount of income should be guaranteed even for those people who have not paid the necessary level of contribution to receive the appropriate minimum benefit. - Third, a pension system contains a social - economic function: the accumulated pension contributions can be invested in favor of economic development of the country and return to the employees in a later period in time, in the

form of poverty alleviation or regular distribution of pension income (ECLAC, 2006).

How successful is the Albanian pension system to fulfill these functions?

This study through a descriptive analysis of the current pension system in Albania identifies issues and challenges for the development of a sustainable pension system in the context of socio - economic development of the country. The paper presents the suggestions to improve the pension situation in Albania. The analysis is based on data collected through literature survey; statistics come mainly from Social Insurance Institute and some studies of World Bank, International Labour Organisation etc.

The paper is organized as following: Section 2 provides a theoretical framework of pension system. Section 3 presents the current pension system in Albania. In section 4 highlights the problems of pension system in Albania. Section 5 identifies major challenges for the development of a sustainable pension system. Finally, this paper will end up with the conclusions and suggestions to improve the pension situation in Albania.

2. Pension System - Background

Much of pension systems are actually managed in public manner and pay defined benefit (DB - Defined Benefit), based on formulas that are based on employee salaries, years of service and are funded by contributions of those who pay today based on the

system "pay-as-you-go" (PAYG). PAYG systems are managed primarily by the state. In these schemes the asset is transferred from one generation, active employees to another, pensioners. This system is like a contract between generations, where one generation provides pension needs of a next generation, the generation which now is retired. Existing systems are not always able to protect the elderly; they will not protect those who will grow older in the future. Often the benefits are unevenly distributed, hindering economic growth as a result of the return of the pension scheme in the main aggravating of GDP. To avoid these problems is recommended switching to systems that are partly defined contribution, capitalized and managed privately (in a defined contribution scheme, the contributions are defined and not the benefits and the future pension depends on accumulated contributions plus the returns from investment) rather than to systems with defined benefits PAYG totally and publicly administered.

The report of 1994 of the World Bank "Averting the Old Age Crisis", presented a model three-pillar pension system. This model has become a common point of reference for thinking about the design of the pension system and reform. The first pillar is a pay-as-you-go pension schemes with defined benefit (DB) publicly managed and financed by social insurance contributions. These traditional pension schemes are based on the principles of social insurance. The second pillar is mandatory contribution, defined (DC - defined contribution) funded, managed privately and based on individual accounts. The third pillar is voluntary, privately managed, for people who want more financial benefits in old age.

In the 2005 report "Old Age Income Support in the 21st Century", the World Bank has added more nuances to its basic model with three pillars. The new model with five pillars adds a zero pillar that provides a minimum level of protection, as well as a fourth pillar which includes the family support. Multi-pillar model of World Bank provides a notion now widely accepted as a mixture DB and DC schemes, with varying degrees of social risk grouping, which is necessary for a well functioning pension system.

3. Structure of the pension system in Albania

The pension system is an important element of social protection in Albania. In Albania, there are currently treated with pensions around 19 percent of the population, with clear trends towards increasing their numbers (SII, 2013). Although the pension system in Albania has passed a series of important reforms in the years 1993, 2002 and 2005, it still faces a number of challenges (ILO, 2012). Actually the pension system in Albania is dominated by mandatory public schemes,

which today is managed by Social Insurance Institute. Social Insurance Institute (SII) was created in June 1992, operates as a pension fund and is a genuine financial broker. Mandatory public scheme occupies most of the payments and benefits. Other income may come from bank interest or penalties imposed on offenders, which are classified as secondary income. The rest is subsidized by the state budget.

Law no. 7703, dated 11.05.1993 "On Social Insurance in the Republic of Albania", as amended, established a public mandatory system and with universal social security coverage and a voluntary supplementary pillar, which despite of having a complete legal framework does not appear to meet yet development. Mandatory system comprises:

- The scheme of compulsory social insurance, which is administered by the Social Security Institute and covers all employees in the public and private sector and self-employed in urban and rural areas, provided they have contributed for a specified time in the scheme. This obligation is legally designated where employers and employees shed a certain percentage in relation to their gross salary, but not more than five times the minimum wage, which is determined by the decision of the Council of Ministers. Currently the minimum basic wage in Albania is 22 thousand ALL (Council of Ministers Decision No. 573, date 03.07.2012). Employers shed 9.5 percent of gross wages, employee and pour 15 percent of gross salary, which as a legal obligation of employers are left to collect and pay to the account of the Department of Taxation to be transferred to the social security budget. This constitutes the main income of the Social Insurance Fund. Another source of income consist of payments done by the self-employed persons in agriculture, who according to specific decision of the Council of Ministers, shed a certain amount of a money and which is collected and administered by the Social Insurance Institute. The current contribute amount for self-employed in agriculture is 30 thousand ALL for lowland areas and 23 thousand ALL mountainous areas (Council of Ministers Decision No. 581, date 17.07.2013). We have to emphasis that this contribution amount is annual.
 - Voluntary scheme includes those who are not insured, those who have been and want to continue to be, and those who are not covered by the law as well as university students.
 - Supplementary scheme for the senior constitutional functions, civil service and military employees in the military, police and intelligence service.
- Supplementary pensions, which are funded directly from the state budget, as well as special pensions for those who have taken part in the war, which have titles in the field of culture, arts, economy and politics as well as persecuted by the communist regime. Special

pensions are funded directly from the state budget as well.

3.1. Types of pensions

The pension system includes three types of pensions: old age pension, disability and family pension.

- Old-age pensions (for adulthood). In order that an individual has eligibility for old age pension, he must contribute to ensuring a defined period of 35 years and then he could receive a pension when he reaches the age of 65 years for men and 60 years for women. Meanwhile, a reduced retirement pension may also be obtained up to three years before the age, but with the condition that the insurance periods completed 35 years and not less than 62 years for men and 58 years for women. Persons who meet these two conditions, despite the application of the formula for calculating the amount of pension, receive a monthly amount, which may not be less than the minimum pension, which is determined each year by the Council of Ministers. On the other hand, even when the monthly pension amount calculated under the formula results in high, it cannot be greater than the maximum pension, which is double the legal minimum pension. Pension calculated according to the formula, cannot be greater than net realized average salary for three consecutive years in the last ten years of work, multiplied by 75 percent. Even after these restrictions, in each case the pensioner receives the smallest amount, which resolved between the amount resulting from the calculation according to the formula, and calculating the maximum limit of 75 percent of salary net. If the employee has contributed to the scheme beyond retirement age set by the law, he receives an additional pension of 0.34 percent on pension, multiplied by the number of months worked on age. Insured persons who do not meet the legally determined period of 35 years and have contributed to the scheme for more than 15 years, benefit partial retirement pension at the time of completion of the retirement age and the cessation of economic activity. Size of partial pension is calculated based on the formulas for calculating the full pension, but corrected it with a coefficient, which is defined as the ratio of the number of years that a person has contributed to the scheme and the number 35 (which are the years of insurance to earn full pension).

- Family pension. When a person, who was retired, and was expected to win the right to old age pension or disability, dies, then the people who are his dependents are entitled to family pension. Family pension is part of the pension which the deceased had won or would win. Calculation of the amount of pension is the same as in the case of old-age pension but can be complete or partial depending on members participating in this

retirement who may be children, husband and wife or parent.

- Disability Pensions. Insured persons that cannot continue the period of insurance for health reasons unrelated to employment or due to occupational injuries caused at work, earn the right to a disability pension. Minimum period of insurance necessary to obtain a disability pension is as invalid age minus 20 and divide the result by 2. While in cases of health damage is caused as a result of an accident at work or occupational disease, the right to benefit arises independently of the insurance period. Monthly disability pension is calculated by the same rules as the old-age pension, and may be complete or partial depending on the health status and reduced due to not meeting the minimum period necessary insurance.

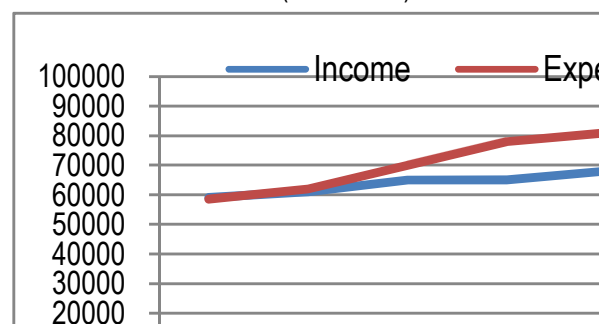
Social Security law provides protection to employees in case of sickness, unemployment, accidents at work and in the case of maternity. The greatest need for reform arises to mandatory schemes, which holds the largest share of the functioning of social protection in our country and that is intended as ensuring full coverage of the country's population, with elements of mandatory social security, held at acceptable levels.

4. The problems of pension system in Albania

Pursuant to Law No. 7703 of 11.05.1993 "On Social Insurance in the Republic of Albania", amended the Social Insurance Fund should afford itself, based on statutory income deposited and managed by it, all expenses, including administrative expenses for the operation of SII.

Dynamics of performance indicators in the years of income and expenses SII is given in Figure 1.

Figure 1. Income and expenses of Social Insurance Institute (2007-2013)



(Source: SII, 2013)

The figure clearly shows that there is an increasing difference between revenues and expenses that should be covered from the state budget through subsidies that the government is obliged to provide SII, to cover all payments incurs as liability of the applicable law. The reasons for this deficit that is created may result from:

- Reduce the rate of compulsory contribution spill has led to less revenue for the scheme. This rate has decreased from 42.5 to 38.5 to 29.5 and finally 24.5 percent in the gross salary, which has directly reduced the amount of revenue that will be siphoned off to the compulsory scheme.
- Reduce of employment rate that becomes more evident due to the global crisis is bringing about the decreasing of the income.
- Rates of increasing the number of beneficiaries. As a result of reforms undertaken in 2005 to increase the retirement age, the pace of increasing the number of beneficiaries of the scheme is increased and consequently the costs to meet them keep growing.
- The low rate of profitability by pensioners. This low rate is due to the slow pace of growth of the real size of pensions over time. Therefore, the schemes become less attractive to increase the number of contribution persons.
- Low value shed by employers in agriculture. The amount shed by the self employed in agriculture is very low in comparison with values that must pay an employee or self-employed. In addition, subsidy policies that governments pursue over time or occasionally increase the burden on the sector by buying previous periods at small amount of money or negligible.

Analysis of the current state pension system in Albania raises questions: If government does not interfere to regulate budget deficit, is the social security a bankrupt scheme? How much does the social security scheme burden the state budget? Does it affect the economic performance of the country this deficit that is increasing? Does this social protection scheme meet the needs of society?

Propping up insurance scheme is impossible without government subsidy. The government is obliged to provide a large "cake" budget to subsidize the huge deficit that comes and expanding and growing concern for the government. This deficit is putting pressure the government to lift the huge funds from other budget expenditures. On the other hand the scheme cannot function without being subsidized, because the payments are required by law to conduct and fund financial opportunity is limited and is impossible to cover payments to most vulnerable strata of society such as pensioners, orphans or disabled.

Referring to the figures, the subsidies in the past two years are 19110 million ALL and 29330 million ALL, who make up for last year of 2.26 percent of GDP, which is a very significant for our economy.

On the other hand, this subsidy is putting great pressure and economic growth. If these large sums constituting about 26.2 percent of GDP will be addressed in other sectors of the economy to promote

economic growth, we can say that the increase would be greater than the percentage of the subsidy scheme. The result will be a growing economy and an improvement on the other indicators mandatory scheme.

Despite the subsidy, the scheme still has deficiency in achieving its goal, to provide a fair benefit for all those who have contributed for a certain period. Against the analysis presented above, it is necessary to intervene in the law which regulates insurance mandatory. So it is emergent the reduction of largest deficit that deepens over time and must be lowered until the balancing scheme comes up with surplus income. This would result not only in its self-functioning, but will enable the other hand the possibility of real growth and benefits for all beneficiaries of the scheme. System analysis makes evident its functioning problems in current economic conditions of our country. In order for the system to fulfill the functions for which it was established, to be financially sustainable and adapt to the developments of socio- economic future of the country, the only alternative left to continue its reforms.

4. Major challenges

The placing of the propulsive elements of the increasing of participation and payment of the taxes on real wages by eliminating the factors that have led to the secession of the size of the pension contribution, especially in the case of salary above average contributors. Obviously, we are dealing with a typical formula defined benefit. Although in principle the method of calculating the retirement pension benefit takes into account the number of years of insurance and thus provides greater retirement benefit who has contributed more to the social security scheme. The maximum limit of retirement, being taxation, as well as the limiting of the calculations with 75 percent of the net average wage, in fact, weakens the dependence of the benefits from the size of the contributions and the link between them. While in the maximal level is achieved a replacement degree of retirement/net salary at 75 percent. The proportion, due to the limitation of maximum pension, always tends to decrease and theoretically that of maximum wage remains at the level of 35 percent. So, for these wages the solidarity level is very high.

- Improved pension indexation formula and the abrogation of rules that lead to rapid erosion of the degree of substitution.
- Increased participation in the contribution scheme. The number of contributors to the labor force is at too low. This indicator is worse in rural areas where the number of contributors to persons employed does not exceed 50 percent, although the government has decided low contribution rate. Although indicators rank

us among the countries of the region still unemployment is considered at high levels. Compared with GDP growth, employment rate is lower while the employment rate that expresses the ratio between the population of working age and the labor force is almost the lowest in the region, about 45 percent. Opportunities to undertake reforms and their types are numerous, but their success or failure depends on the quantity and measures for securing funds that will finance the system. Pension reforms, despite the changes that have between them, are achieved and realized through contributors and beneficiaries who are considered as "beneficiaries and contributors". Any structural reform must take into consideration that parametric adjustments will be needed to keep the balance of the public pension scheme. People who benefit from it, they deserve the rights acquired and of course have the right to demand more for improving the quality of their lives. The task of the present employee generation, but also of the initiators of reforms is in the first place to guarantee these rights, to make them more durable, but also create initiatives.

5. Conclusions

The pension system is an important element of the social protection system in Albania. Although the pension system in Albania has passed a series of important reforms in the years 1993, 2002 and 2005, he still faces a number of challenges (ILO, 2012). Currently the pension system in Albania is dominated by mandatory public schemes, which today are managed by SII. System analysis makes evident its functioning problems in current economic conditions of our country. In order that the system fulfills the functions for which it was established, to be financially sustainable and to be adapted to future socio-economic developments, the only alternative left is to continue its reforms.

To reform the system should intervene on both sides of the balance to both contributors and beneficiaries. More specifically should be considered the possibility of:

- Creating a fairer relationship between contributions and benefits. In other words, the possibilities for removing the maximum pension limit which is bordered by two minimum pensions when it is contributed to five times the minimum wage.
- Revision of the level of the salary contribution rate, seen first in a long-term perspective of how will influence the lowering or rising of the rate to increase the number of contributors and in turn to increase the revenue that could be included in the scheme.
- Review of the contribution of rural areas benefits by reducing or removing subsidies of the state budget in this scheme. A continuous subsidy for a long time has adversely affected the scheme.

- The system partition in the contributory system and in basis system.
- Encouraging voluntary participation in the scheme.
- Establishing a minimum vital standard to share contribution scheme from other benefits.

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