Pension system in Albania

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Abstract

The pension system in Albania has fulfilled its basic functions during the transition and now it suffers from some outstanding issues that render its reform indispensable. First, the pension scheme suffers from a very high deficit that renders it financially unaffordable. Secondly, although all elderly are covered by the scheme due to the entire employment during communism,
a large part of the working age population currently is not insured due to high unemployment rate but also informality. This has worsened sensibly the report between contributors and beneficiaries. Therefore, the Albanian pension system is no longer able to balance sufficiency of benefits with affordability of costs. Given the importance of pensions for social protection, it is necessary to intervene immediately to reform the system.

Keywords: pension, system, Albania.

Introduction

The establishment of a comprehensive system of social insurance in Albania is evinced in 1947. The initial social insurance system was gradually consolidated in two schemes: one for public sector employees and another for agricultural cooperative members. This system was, on the one hand, very generous and, on the other hand, it did not provide complete social coverage. It predicted low retirement age and differential treatment for certain categories of employees. The system was financed by contributions from public employers and state agricultural cooperatives, which were naturally part of the cost and the planned price. The system was fundamentally based on generation solidarity, where the contributions collected funded the defined benefits during that period, by way of which the employed individuals would obtain future rights in the social insurance area in the meantime.
Until 1991 the number of employed individuals in the former state enterprises and agricultural cooperatives, who constituted the contributors to the social insurance system, was 1 million 446 thousand. The first beneficiaries of the system are evinced in 1960. According to statistics of the time, in 1966 are evinced approximately 35 thousand beneficiaries, mainly with partial pensions, versus 263 thousand contributors. While at the end of 1991 the number of beneficiaries had reached 329 thousand, reflecting a dependency rate of 4.5 contributors to 1 beneficiary.
The following table reflects the contributors and beneficiaries of the system over some years. The number of contributors has grown year after year and so has the beneficiaries' one. Initially , in the first years , the system 's dependency ratio has been quite favorable , which reflects even a very low rate of contribution to the salary , while recently , in 1991 , the contributor - beneficiary ratio was 4.5 to 1 , at a

contribution fee of 15% of the salary.

Table 1 – Dependency rate of the pension scheme until 1993

	1966	1976	1986	1990	1991	1993
Contributors' total	262,830	520,150	750,982	1,451,212	1,347,616	731,000
Urbn pensions	35,222	88,242	161,704	206,541	244,159	304,020
Rural Pensions		28,814	81,893	112,566	121,502	149,917
Pensioners total	35,222	117,056	243,597	319,107	365,661	453,937
Contributor/ beneficiary ratio	7.4:1	4.4:1	3:01	4.5:1	3.7:1	1.6:1

The number of contributors fell drastically in 1993, but in fact this year the number of contributors was even lower. This, given the fact that in many public enterprises, a major part of workers were receiving unemployment benefits financed from the state budget at a ratio of 60% of the salary and concurrently they were recorded as contributors as well. In 1994, when these payments were also cut, the number fell to 386 thousand contributors. On the other hand, the closure of state enterprises necessitated the establishment of early retirement schemes and therefore the number of pensioners in 1993 increased by 123 thousand reaching a total of 453 thousand. In the pension system prior to 1993, the maximum pension was defined as twice as much as the minimum pension (the maximum pension LEK 700 per month whereas the minimum pension LEK 350), regardless of the salary, while the salaries on which bases the contributions were paid were at a ratio of 1 to 2. For ex – cooperative members, the minimum pension was LEK 100 per month, while the maximum pension was no more than LEK 350. According to the data of the time, the average pension was approximately LEK 460 or approximately 30 % higher than the minimum pension.
The two pension systems were developed and implemented by the end of 1993 , leaving for the new legislation , which would be compiled in compliance and in consistency with the new economic development , an open obligation to open , primarily in two areas: The new system that would be developed , on the one hand , was to face and develop all known fees for known benefits and , and on the other hand , this system was compelled to recognize and take for granted the entire insurance period of every beneficiary in the earlier schemes. The rights acquired by the previous system, which would be implemented in the coming years, were significant. Suffice to mention here that apart from about 453 thousand pensions that were to be paid on monthly basis, a considerable period of insurance for over 1100 thousand people was accumulated as an acquired right. In these difficult economic conditions, also the fundamental principles of the current pension system were defined, which as follows would:

- continue to be contributory;
- implement a solidarity scheme financed by generations;
- take into account the acquired rights for over 1,450 thousand contributors;
- continue to implement two separate pension schemes: one for employees with

a work history in former state enterprises and one for the former agricultural cooperative members, this due to the different background contributions , which were to be aligned over the subsequent years;
• continue to maintain functional the ceilings of the benefit amount and continue to establish a basic amount that would represent a subsistence minimum.

The current pension system

Law no. 7703 dated 11.05.1993 "On Social Insurance in the Republic of Albania" (as amended), created a compulsory, public and universal coverage social insurance system, as well as a voluntary supplementary pillar, which presently, does not appear to be developed irrelevant of all the measures taken and the legal framework already completed.
The compulsory system comprises:
i. A mandatory social insurance scheme which is managed by the Social Insurance Institute and covers individuals employed by the state and the private sector, as well as the self-employed in the urban and rural areas, provided that they have contributed for a specified time in the scheme.
ii. A voluntary scheme that includes those who are not insured any more, those who have been insured and wish to continue to be insured, as well as those who are covered by the law, the university students included.
iii. A supplementary scheme for higher constitutional functions, civil service and military employees in the military, police and intelligence service. The supplementary pensions are financed directly from the state budget.
iv. Special pensions for those who have taken part in the war, who have titles in the field of culture, arts, economy and politics as well as persecutes of the totalitarian regime. Special pensions as well are directly financed from the state budget.
The Social Insurance law provides coverage to the employed individuals even in the event of illness, unemployment, accidents at work and maternity. Currently the social insurance contribution rate is 24.5 percent, out of which, 21.6 percent is paid for the pension branch.
The following is a breakdown of the social insurance and health insurance rate.
Table 2 – Contributions to the social insurance system (as % of the salary)

Insurance branches	The Total	Employer	Employee
Pensions	21.6	12.8	8.8
Illness	0.3	0.2	0.1
Maternity	1.4	0.8	0.6
Work related accidents	0.3	0.3	0
Unemployment	0.9	0.9	0
Total of social insurance	24.5	15	9.5
Health Insurance	3.4	1.7	1.7

The public pension scheme offers three types of pensions: old age pension, disability pension and family pension.

The old age pension

In order to be qualified for old age pension, an individual must contribute for a period of insurance of 35 years and may receive pension when reaching 65 years of age for men and 60 years of age for women. A reduced retirement pension may also be obtained up to three years prior to reaching the pension age, on condition that the insurance period of 35 years has been completed. This type of pension is associated with a penalty of 0.6 % of the monthly pension amount as a penalty for early retirement and this pension amount remains the same during the entire life. Only mine workers who retire at the age of 60 and mothers with many children who retire at the age of 50, are exempted from this law. Individuals who have reached the retirement age and have contributed for 35 years, irrelevant of the formula application for calculating the pension amount, receive a monthly amount which should not be less than the minimum pension, which is annually defined by the Council of Ministers. On the other hand, even when the monthly pension amount calculated under the formula results as high, it cannot be higher than the maximum pension which is legally twice as much as the minimum pension. Besides, the pension calculated under this formula, cannot be higher than the net realized average salary for three consecutive years in the last ten years of work multiplied by 75 %. Even after these restrictions, the pensioner receives the smallest amount, which is estimated based on the amount resulting from the calculation under the formula, the maximum limit and calculation of the of 75 % of the net salary. In the event that the employee has contributed to the scheme beyond retirement age, he/she receives an additional 0.34% of the pension multiplied by the number of months having worked after the retirement age. On the other hand, the insurees who do not meet the period of 35 years of work, as defined by law and they have contributed to the scheme for more than 15 years, are qualified for a partial retirement pension benefit at the time of reaching the retirement age and the cessation of economic activity. The amount of the partial pension is calculated based on the formulas for calculating the full pension , but correcting it with a co efficiency , which is defined as a ratio of the number of years that the individual has contributed to the scheme and the number 35 (which are the years defined for qualification to a full pension).

The disability pension

The insures who fail to continue the insurance period for health reasons unrelated to employment, or due to occupational injuries caused while at work, qualify for a disability pension. The minimum period of insurance necessary to obtain a disability pension is the disabled individual's age minus 20 and the result is divided by 2. Whereas in the event that the damage to health has been caused as a result of a work related accident or occupational sickness, the individual qualifies, irrelevant of the insurance period.

The monthly disability pension is calculated by the same rules as old age, and may be full or partial, depending on the health condition, or a reduced one, because of the failure to have met the required minimum insurance period.

The family pension

When a person, who was a pensioner or was expected to qualify for old age pension or disability pension, passes away, then the people who are his dependents qualify for family pension. Calculation of the pension amount is the same as in the case of old-age pension, but it can be complete or partial, depending on the participating members in this pension who may be: children, spouse or parent.

The formula on monthly pension amount calculation

The monthly pension amount depends on the amount of contributions paid. The monthly contribution amount depends on the gross salary and on the defined contribution rate. Contributions are paid by the employer and the employee, whereas the self-employed pay the entire contribution amount themselves. The contributions of the self-employed in rural areas, are calculated according to a certain procedure upon a DCM, which defines the annual fee for this category of employees. Meanwhile , the state budget fills in by paying the other share of every individual self-employed in rural areas , on condition that he/she has paid his/her share of contribution. The current level of participation in contributions is approximately 45 % to 65 %. The social insurance law covers the insurees even in the event of illness, unemployment as well as maternity. The monthly pension for old age is calculated according to the following legal formula:

$$\mathbf{Pp = Mpb + Sh}$$

- Pp = the complete monthly old age pension;
- Mpb = Amount of the basic pension given to all insurees. This component is annually corrected with the index price of some selected commodities, as provided in the Regulation of the HII and is annually defined by DCM. Currently, its amount is LEK 12.024 per month in the urban scheme and LEK 8.233 per month in the rural scheme;
- Sh = is supplement to the basic pension. This component is individual and it depends on the amount and duration of the contributory period and it is 1 % for each year of insurance, multiplied by the average assessable basis. In the rural scheme, the supplement over the basic pension is calculated as 1 % for each year of insurance after 1994, multiplied by the average assessable basis. The Council of Ministers approves annually, the basic indexation co efficiency assessment, using the growth rate of the average individual contributions of the respective year with that of the previous year. Currently, the average assessable basis is calculated as the average salary received by the employee over all years of work, based on which the contributions are paid. Given that prior to 1994 there are no data on individual salaries, for the purpose of calculating the average assessable basis, the calculations are made on the basis of the reference salaries as defined by the Council of Ministers.

As seen, the Albanian pension system implements a typical formula of defined benefits. Although in principle the calculating method on the old age pension benefit takes into account the number of years of insurance and the amount of the contributions paid and consequently, it provides greater pension amount to those who have contributed more to the social insurance scheme, yet given that the maximum pension threshold is taxable, it weakens the dependence of benefits from the size of contributions. While at minimum level, a replacement rate of 75 % pension / net salary is achieved, this report in cases of maximum contribution payment, given the limitation from the maximum pension ceiling, always tends to decrease and theoretically on the maximum salary it remains at the 35 % limit. Therefore, for these salaries, the solidarity level is very high.

Theoretical issues of the pension reform

Any pension system aims at meeting certain objectives. Individuals and families seek to be ensured and to be guaranteed that when aging they will have sufficient income to survive. On the other hand, the government's main objective is redistribution and poverty reduction. In addition to these objectives other goals must be taken into account, such as the economic efficiency or production increase. Therefore, any reform of the pension system should not only focus on the fulfillment of one of these objectives, but due attention should be paid to each of them. A pension system should be seen in its entirety.

On the other hand, any pension system affects and is affected by the labor market, economic growth, the distribution of risk and income. In addition, the demographic situation, the rate of the financial market development or the administrative capacity of all institutions are considerably important. For these reasons, it is crucial that when planning a pension system maximum attention should be paid to the socio-economic situation of a given country. Thus, one can say with mathematical certainty that, in itself, there is no good or bad pension system. There are systems that when applied in a certain country, function brilliantly, yet when copied and applied in another country result in failure. Each system is good depending on the specific conditions of a country – if it fits all the specifications of a country it is then successful in achieving the objectives mentioned above, if it does not fit, then none of them is realized and the fiscal deficit deepens. Theoretically, the pension systems should be based on three pillars in order to achieve the objectives above. The first pillar deals with pensions which objective is poverty mitigation. The second pillar provides private or public pensions, which are generally mandatory. Based on the principle wherein the pension depends on contributions paid, their main aim is to guarantee sufficient income in order to ensure continuity of consumption in old age. The third pillar is generally voluntary and mostly aims at satisfying the differences in individual preferences.

In order to accomplish these goals, a country can choose between a myriad of systems, however the choice is conditioned not only by socio-economic characteristics of a country but also by fiscal constraints. A country with lower middle income like Albania, in theory, should choose a pension system as follows:

The first pillar. To realize the objective of poverty reduction, a country like Albania can choose between;

A non-contributive social pension which is financed by general taxation (such as offered by Australia, Netherlands, New Zealand, etc.); or

A simple contributive pension funded according to the principle Pay-As - You-Go, as

for example a flat pension which amount depends only on the number of the insured years and not on the salary level or contributions paid. (as the Basic State Pension in Great Britain or the Old Age Pension in Canada)
The second pillar. In order to achieve the objective of guaranteeing income, a country like Albania may choose between:
-A contributive public pension with defined benefits or , if possible , a notional pension with defined contributions, or
A pension with defined contributions as part of a national savings fund, or private pensions but with limited opportunities for individual choice.
The third Pillar. Given that this pillar aims at satisfying individual preferences, then it must consist of voluntary private pensions with defined contribution at company level or individual level.

Theoretical issues of the social pension

By way of summary, a pension system must balance the adequacy of benefits for the elderly and spending affordability for state finances. Currently, the Albanian pension system has a very deep deficit and a very low coverage rate. The coverage rate of the current scheme is very low which means that there are a great many citizens who live at risk of remaining without pension and in poverty. This is politically and socially unacceptable. In this way, it is necessary to create a social pension that will offer a flat fee for each person of senior age in order to bring them above the poverty line. This would ensure that all seniors would be covered by the social insurance system. States that have such a pension scheme such as Canada, the Netherlands and New Zealand have the lowest level of poverty in the world for the third age. Besides, these countries spend much less on pensions (about 4-5 % of GDP) compared to other developed countries.
However, such a pension has the disadvantage that individuals with middle income and higher income, when retiring, will suffer a drastic decrease in their income and would require higher pensions. Therefore, it is necessary that a second component be added to the social pension in which the pension amount would depend on the contribution level. This requires that the pension design and effects of the social pension, be seen in this broad context of the whole system and not as a fragment of it. The social pension can be funded in two ways. The first is that this pension be funded from general taxation. If financed in this way then the contribution fee would decline given that individuals would only contribute to the second pillar, i.e. for the contributory pension. The reduction of the contribution fee would enable a fiscal space needed for a growing income tax with a view to funding spending for social pension. In the majority of the countries that apply such a pension, the pension amount depends on verification of income. In Australia, for example, the pension level decreases when the income from other sources is higher than a specified limit. New Zealand on the other hand, defines as a condition for receiving this pension only the residence.
The advantage of such a pension scheme pension in Bangladesh is the one that solves the coverage issue, i.e. informality. Given that the participation in this scheme is not

restricted by the condition to be insured, any individual who has reached the age of retirement qualifies for a monthly pension. On the other hand, given that it is funded by taxation, the financial burden is distributed more evenly among the economically active population, whereby the number of those indirectly contributing to the pension scheme will increase significantly. However, such a scheme has also disadvantages. Even though by definition, mandatorily the payment of contributions goes to the second pillar, the possibility provided to receive a pension in old age despite being insured, would result in non contribution at all to the contributory scheme by most individuals. This would provide only minimal income for the seniors who would cause pressure on the government to increase the amount of pension and political parties can make use of it for electoral reasons by increasing the pension amount at the expense of state finances.
The second possibility is that the social pension be funded by contributions according to the simple principle PAYG. Even in this case the pension is flat but in a system where the link between contributions and benefits is strong, the social pension would play the redistributive effect. Given that it is flat, it would help the individuals who have paid fewer contributions, or who have contributed for few years to reach a subsistence level. Countries applying this scheme condition provision of social pension with the residence (Canada), with the number of years insured (Great Britain), and the verification of income (Canada and UK). Thus, the social pension amount decreases in direct proportion to the increase of the pension amount from the contributory scheme and / or to the increase of the individual's income from other sources. Likewise, the social pension amount depends on the number of insured years as well. Those individuals, who have contributed during the entire period as required by law, receive full pension, while those who have contributed less, receive a partial pension. For example three trends can be created: those who have contributed for 15 years receive 40 % of the social pension, those who have contributed for 25 years receive 70 % and those who have contributed throughout the period needed, obtain full pension.
The biggest advantage of such a scheme is that it keeps individuals within the scheme and conditioning the benefit amount with the number of the insured years, encourages them to become part of the scheme. Therefore, such a system, in principle, would result in reducing the informality level. The disadvantage of this scheme is that it provides no benefit to individuals suffering from long-term unemployment or who do not work at all throughout their lives. However, this is only in theory, because in practice it is difficult to find someone who throughout his life has not been employed for at least 15 years. As for those who do not work because of a disability, they are treated by social services during their lifetime and may continue to do so even in old age.
1). Improving the current system parameters
Such a reform enhances the contributory principle of the current system and eliminates the high degree of redistribution that characterizes it, giving more incentives for individuals to be part of the social security system as well as to contribute more by declaring the real wage. On the other hand, this option also provides for a social pension for all those elderly who do not qualify for a pension

benefit. In the reformed scheme, the basic pension will be replaced by the social pension. Besides, the restriction to the maximum pension will be lifted and rendered to the double of the basic pension and the calculation with 75 % of the net salary will also be removed. Likewise, the reform aims at eliminating the difference between the urban and rural pension and offers no privileges for farmers but includes them in a scheme. The realization of this reform requires the following measures to be taken:
• Changing the pension calculation formula in:

P = PS + Sh

- P is the amount of the monthly pension.
- PS is the social pension, the amount of which is not higher than the partial pension obtained from the contributive scheme.
-Sh is the supplement, the value of which is 1 % of the assessable basic amount for each year, which represents the ratio of average contributions in the current year to the average contributions of previous years.
• Accurate and strict rules for the indexation of the maximum contributive pay by forecasting only indexation until 2020.
• Remodeling of limitations on the pension amount by rendering the ceiling of the maximum pension up to the double of the basic pension or by extending the borderline from 1 to 2 into 1 to 4.
• Increasing the minimum contributive pay and indexation of the maximum contributive pay, as well as the removal of 1 to 5 ratios between them.
• Increasing the years of social insurance contribution from 35 to 40 years until 2025
• The gradual increase in the retirement age for women to three months per year , in order to reach to 63 years in 2030 and 65 in 2040 – being in compliance with the average of the OECD countries.
• gradual removal of privileges for the recognition of insurance periods without paying contributions for women, such as recognizing the years of study as insured years.
• Improve the calculating mode of pensions for mothers with many children and family pensions by defining the retirement age as an age for benefitting the spousal pension.
• Increase the contribution rate for rural areas by equaling the farmers' contributions to those of the urban areas by 2017.
• Improvement of the pension formula for rural areas. This day, for example, a farmer who has over 17 years and six months of insurance in the state, or as self-employed, including the cooperative insurance, qualifies for state pension. This period of insurance will increase gradually (one year per year) until extinguishing completely the recognition of the period as cooperative member.
• Establishment of discouraging elements for early retirement.
• Encouraging later retirement pension, by increasing the individual contribution and decreasing the pension years.

Conclusions

This manuscript showed that all individuals who do not meet the necessary conditions to qualify for a pension will receive a social pension, which can only be acquired by individuals over 70 years old who have been residents in Albania during the last 5 years. The amount of this pension shall not be higher than the partial pension amount obtained from the contributive scheme. This pension will be granted as conditioned by the verification of income and will be financed from the state budget.

The supplementary pensions for governmental political officials, professors, military etc will be reviewed aiming at a better link between contributions and benefits and the reduction of state subsidies. The reform will aim to increase the retirement age (political functionaries at 55 years), the increase of the contribution amount as well as the change of the benefit calculation formula. (Example: today an MP or minister, for x lek contribution paid, receives 39 xlek as benefit - the formula will be amended in such a way that they shall benefit 10x more and not 39x more).

The occupational schemes for difficult occupations will become legally mandatory and they will include some categories of mining industry workers and other category employees such as oil, metallurgy, art and culture etc. These schemes shall aim to guarantee income for individuals who retire earlier than the official retirement age. They will be contributory, whereby the contribution amount shall be divided between the employers and employees and it shall be created on the basis of collective agreements. The Supervision of these schemes will be carried out by the Financial Supervisory Authority.

The private pension funds shall continue to be based on the free will of citizens to contribute. However some measures will be taken to improve the performance of these funds. First, some fiscal relief should be provided. This day, these funds are dually taxed, given that both the contribution and the benefit are taxed, while only benefits should be taxed.

References

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