NEED FOR A SECOND PILLAR IN THE ALBANIAN PENSION SYSTEM

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ABSTRACT

The pension system is an important element of social protection in Albania. Although recently reformed, the Albanian pension scheme faces unsolved challenges resulting from this reform. Pressures from the current and expected demographic changes, high emigration rates of the most vital part of population during the last years, constitute a serious problem that the Albanian pension scheme is facing. The above factors and the high deficit of the scheme urge a debate about the way how the pension scheme reform should be viewed. Alternatives of the reforms are many, but if we consider the current functioning of the scheme and its specifics, one of the reforming options might be to equip it with the second pillar as based on the model used by many developed countries. This paper refers to the discussion about introducing three necessary pillars of the pension systems in the Albanian scheme, so that it is able to face the challenges and provide safety, thus to be financially sustainable and adoptable to future social-economic developments.

Keywords: Reform, pension system, pillar, Albania.

INTRODUCTION

The last reform undertaken in Albania in 2014 ensured the domination of the public compulsory system PAYG (pay-as-you-go) in the Albanian pension system. In spite of many efforts to improve it, the already applied reform did not aim the solution of problems, such as high deficit of the scheme and the increase of the beneficiaries' number - detected as the two biggest macroeconomic issues of the scheme in the pension system. The last reform did not find any final solutions to two above mentioned issues and neither did to other issues; instead it tried to defer them in time. According to Schwarz (2006), the pension reforms can be classified at least into four different categories: parametric reforms, which include changes of parameters in the actual pension systems; systematic reforms, which include the introduction of a new kind of pension systems for replacing or completing the existing system; regulatory reforms, which include changes of the fund investment rules which could be invested and; administrative reforms. Parametric adjustments applied by the reform and that intervene in the system's parameters, only delayed the solution of problems. Moreover, the increase of gradual retirement age for women from 60 to 67 year old and for men from 65 to 67 year old did not solve the problem; rather it extended it in time. Such virtual solution, by decreasing the number of people who retire and the total payment of pensions will be temporary until the moment of parameters maturity amended in the system. Very much so, in order to solve the scheme problems and without deferring them in time, necessary reforms to be applied should be taken into consideration. One of the alternatives that needs to be discussed is that of complementing the system with the second pillar along with the existing ones, which is missing in the Albanian pension system.

What are pension schemes and how do they work

The retirement program, or the so called the pension system is a special scheme for generating incomes to those individuals whose age makes it impossible to earn incomes through work. This system is a part of social security system, which has been established for increasing the wellbeing of an individual in event of misfortunes caused by accidents, disability to work, etc.

The pension schemes take the main part of social security. The pension systems have multiple goals: fight poverty, mitigate consume, provide safety, are a means of re-distribution within and along generations (Barr and Diamond, 2008). Generally, these are compulsory systems applicable to all; they protect the citizens from diseases, invalidity, and aging. These schemes are provided by the Government. Generally speaking, pension is an agreement which enables people to get incomes when they are old, when they cannot provide them through employment. Pension is a saving instrument which allows accumulation tax free of a money reserve so that is it used later as an income from retirement (ILO, 2006: 25). Retirement payment is the benefit more widely extended as far as retired population is concerned. Pension, according to Williams and Windebank (1998), is the entirety of planned procedures and a legal process for establishing a safe fund, for meeting the social protection obligation which employers owe to their employees when they retire.

While the capacity of an older person to work decreases with age, his/her dependency shifts towards household transfers. In many traditional societies, family or relatives take care of older people, invalids or those who lose the person who brings incomes at home. But there are those people in society who have no family and relatives; even if they do have relatives, they might not have sufficient incomes or are not willing to take care of these people for a series of reasons. In today's societies, individuals have lost the kinship by leaving the country where they grew up and leaving the elderly or invalids without help. For this reason, the individuals try to save during their whole life, but since safe financial markets are lacking, often savings leave people vulnerable when they do not generate incomes from employment. All these factors risk the lost of incomes once and for all. For all these reasons, governments take measures for establishing protecting systems for individuals of their societies and one of these systems is the pension system. Starting from the end of 19th century, several countries took measures for establishing protecting systems for older people. The pension system is a special scheme for social protection, which serves for providing incomes for individuals when they retire. They are designed for ensuring incomes for those individuals who undergo loss of incomes as result of advanced age, disabilities, or death of a family bearer (Whitehouse, 2009). The word "pension" implies a payment flow for providing incomes that start from the moment when the individual retires until the chain of life times out.

The objectives of the pension systems are:

1. Try to reduce poverty among elderly.
2. Try to reduce the consumption between the active period of work and the retirement period, so that an individual does not experience decline of the living standards (Schwarz, 2006).

Pension schemes have three main sources: employees' contributions; employers' contributions; and returns of investments (NIRS, 2016). Establishment of a right and fair pension system is of a great importance. Retirement payments are important not only from the economic and financial aspect, but from psychological and political as well.

The pension schemes as classified for the above reasons are of two types:

1. Contribution scheme

2. Non-contribution scheme

Contribution schemes are those schemes on which beneficiaries must have made financial contribution for a minimal number of professional activity periods before they benefit. The contribution might be in the form of fees for the social security withheld from salaries and/or in the form of contributions made on behalf of the employee by the employer.

Non-contribution schemes consist of cash transfers, funded by taxes, for older people in need. These schemes that address to the vulnerability and poverty of older people include social assistance, which provides help for poor families including older people and social pension schemes are focused explicitly on this one.

Multi pillar system in the pension system

The report from the World Bank published in 1994 “Averting the old age crisis: Policies for protecting the old aged and encouraging growth”, is pointed out that systems that ensure financial safety for the elder are under an increasing pressure all over the world. Since the publication of this report, many events have occurred in the aspect of pension reforms within a short period. Discussions about the pension reform refer to “multi pillar” systems.

What does a pillar contain exactly?

Different authors define the term differently, by trying to reach the key dimensions in designing the national pension systems. Many authors consider important the following elements while describe the systems:

- Coverage: Is it universal?
- Participation: Is it compulsory or voluntary?
- Contributions: What pension system are paid the contributions in: a general payment system or a system based on individual benefits?
- Benefits: What level benefits in pension reflect the longevity of the retiree?
- Financing: What level do assets cover for future liabilities?
- Management: Is it public, private or is there a mix between the two?

Categorization of the systems based on these criteria is not easy. If all the above elements are taken together, they result in the “multi pillar” system defined as following:

The first pillar: large systems, compulsory and public or almost public with re-distribution along and within generations.

Second pillar: systems fully financed, with defined contributions, where benefits depend on assets in the account of the individual who retires. These can be:

a) Systems of the pension fund, which are centralized, managed by government and usually provide benefits “lump sum”, but they may offer a pension.
b) Individual systems of financial accounts where contributions of participants are invested in financial markets managed privately.

These two pillars could be completed by a minimal guarantee: a guarantee without considering the way it is designed, is financed by general taxes and based on its definition it breaks the direct link between contributions and benefits.

Some called it necessary guarantee or “0 pillar” of pensions.

Third pillar: Countries also provide a last means of safety in the form of social assistance for more people in need. The first and second pillars can be complemented with regulated governance systems, voluntary or half voluntary, pension systems managed privately. These systems are often referred as the third pillar (World Bank, 1994).

Structure of pension system in Albania

Pension system is an important element of the social protection in Albania. Currently, there is 20% of the population that receive retirement payments in Albania; there are clear tendencies of increasing their numbers (ISSH, 2018). Although the pension system in Albania went through a series of important reforms in 1993, 2002, 2005 and 2014, it still faces a number of challenges. Presently, the pension system in Albania is dominated by the compulsory public scheme which is managed by the Institute of Social Securities (ISSH). It is established in June 1992. It operates as a pension fund and is an authentic financial intermediate. Compulsory public scheme takes the larger part of payments and benefits. The compulsory system is made up of:

- Compulsory social security scheme managed by the Institute of Social Security and covers all employees in public and private sectors, as well as self-employed in urban and rural areas provided that they have made contributions on the scheme for a specific period of time. This obligation is legally defined where employers and employees make a certain contribution depending on their gross salary, but it should be no more than fivefold the minimal salary which is defined by decision of the Council of Ministers. The employer contributes with 9.5% of the gross salary, whereas the employee contributes with 15% of the gross salary, which being a legal obligation are collected by the employer and are cashed on the account of the Tax Office. From here, they are transferred to the Social Security's budget. This constitutes the main income of the Social Security fund.
- Voluntary scheme that includes those who have no more social security, those who have had and want to have social security and those who have no legal coverage.
- Supplementary scheme for higher constitutional functions, civil services and servicemen who are employed in military, police force and information service.
- Supplementary pension that are financed directly by the state budget as well as from special pensions for those who participated in wars, bear titles in culture, arts, economy and politics and those who were persecuted by the communist regime. Special pensions are financed directly by the state budget too.

Pension types

Pension system involves three types of pensions: retirement, invalidity and family pension.

- Retirement pension (for the old age people). In order to gain the right for a retirement pension, the individual needs to contribute for a specific period and should get retirement payment when he/she reaches the right age, according to law. Persons who fulfill these two conditions, despite of having applied the calculation formula for the pension payment, shall benefit a monthly amount, which cannot be less than the social pension, as determined each year by the Council of Ministers.
- Family pension. When a person who is retired or is expected to gain the right for a retirement or invalidity pension passes away, persons who are in charge of him/her have the right of a family pension. Family pension is a part of pension that the deceased had already benefited or would benefit shortly. The calculation of the pension rate is the same as in retirement pension, but it might be complete or partial depending on the members who share this pension which may be: children, spouse and parent.
- Invalidity pension. Persons who have made contributions for social security and cannot continue to do so for health reasons (that are not related to employment) or for injuries in the workplace, gain the right of benefiting the invalidity pension. In cases when health is affected because of an accident in the workplace or professional disease, the person is also a beneficiary regardless of the contribution period. Monthly

invalidity pension is calculated the same as the retirement pension, and might be complete or partial depending on the health condition. It might be as well reduced because the minimal period which is necessary for being secured, has not been complete.

Law of social security protects the employees in events of diseases, unemployment, accidents in the workplace and maternity leave.

Need for undertaking new initiatives

Although is not long since the last reform in 2014 in the pension scheme, the first issues already have started to come out. The last reform was applied as an adequate and fast necessity without having analyzed all the possible alternatives. There is a need for discussing the reforms in order to precede the situations where the scheme was before the last intervention. Yet, the whole pension system needs to be analyzed thoroughly in depth on three aspects. The first aspect of the analysis is related to issues of the system before the last reform; the second aspect is related to the actual analysis of the system. These two first aspects place us in front of such dilemmas:

What were the weaknesses of the Albanian pension system?

Are there unsolved issues in the current pension system?

Are the scheme problems solved definitively or just postponed?

The answer to these questions poses the question marks that affect the system's future:

Is there anything more left?

Is there a need for reforms in the future?

Is there a need for parametric reforms only or should be intervened with systemic reforms?

Four years after the last reform, a clear analysis is necessary in order to go above political prerogatives and check the technical opportunities of the reforms. It is known that pension reforms affect the interests of the population. Generally, reforms involve several generations and so they involve different social groups. Such a complex area like pensions combines many interests and expectations. Therefore, when reforms in pensions are discussed, there need to be considered the fact of where we are and were we need to go for satisfying the interests and expectations of all actors who are affected by the reforms.

Why a second pillar in the Albanian system is necessary?

Pension reform has been aplied for a couple of years already, and although it is still the beginning, it faces emigration challenges of the new labor force, fast aging proces of the population, decline of contributors who work in agriculture and increase of deficit in net values. Pension scheme in Albania is not financially balanced. Such financial unstability comes as a result of the reduction of the contributors‘ numbers on one hand and increase of beneficiaries on the other. Other reasons are: non-disclosure of real salary, relatively high number of retirees compared to the young population, young age of retirees as result of being retired early in the beginnings of the 90s and young age of retiring for some special categories, demographic changes, unemployment levels and high levels of emigration for the labor force. In 2016, the deficit between incomes from contributions and benefit expenses was more than 44 billion Lekë (ISSH 2018). This deficit put into risk the finaccial stability of the pension system. Another challenge that the system needs to face is undoubtly the aging population. For these reasons it is necessary to establiush the scheme based on contributions. Such scheme would bring a lot of advantages for the system of the Social Security in Albania as well as for the country's economy. Advantages start from the increase of the scheme's financial stability; rdecline of informality in labor market, through a stronger relation between contributions made during the working years with benefited pensions; as well as a more suitable pension level for it would be based on contributions. It is worth mentioning the fact that the main objective of pension supervision is that the pension fund must be able to meet the expectations communicated to the members, related to advantages and risks the fund is exposed to. Besides, it should not be left aside the poor level of development of the third pillar in Albania for the fact that it is a voluntary scheme. This scheme has been established with defined contributions, is capitalized and is in line with the latest global trends. The contribution of the third pillar is insignificant in comparison to the Albanian economy, so that a reform that would adapt the scheme with the second compulsory pillar would revive the pension system. It would contribute to addressing long term challenges that accompany it. The more powerful the role and importance of the second pillar on the pension system, the more significant will be the advantages from the reform, increasing the pressure toward the reduction of the system's deficit as a whole.

CONLUSIONS

The pension system is an important element of social protection in Albania. Pension systems have multiple goals: fight poverty, mitigate consume, provide safety, are a means of re-distribution within and along generations. Although the pension system in Albania has undergone a series of important reforms, it still faces a number of challenges. Currently, the pension system in Albania is dominated by the compulsory public scheme, which is managed by the Institute of the Social Security. The system's analysis identifies the problems of its operation and function under the actual conditions of the economic development in our country. Pension scheme in Albania is not financially balanced. Such financial instability comes as result of the reduction of contributors' numbers on one hand and increase of the beneficiaries' number on the other. Another challenge faced by the system is undoubtedly the population aging process, which causes a sharp and sensitive rate of dependence. For these reasons, it is necessary to establish a scheme based on contributions. So that, adopting the scheme with a second compulsory pillar, would revive the pension system by addressing to long term challenges which accompany it. The more powerful the role and importance of the second pillar in the pension system, the more significant the advantages of the reform, increasing the pressure towards the reduction of the system's deficit as a whole.

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