The Need for a Pension Reform and its Social Impact – the Albanian Case

AIDA GUXHO
ARETI STRINGA
Faculty of Economy
University of Tirana, Tirana
Albania

Abstract:

The purpose of this paper is to analyze the need to reform the pension scheme in Albania and the social impact that would have the implementation of new pension system. Albania inherited a pension system which is DB (Defined Benefit) - mono pillar pension scheme. After 90's, the Albanian government has undertaken some reforms on pension system such as the parametric reform of 2002, but the pension system is still facing problems. The need to shift from DB (Defined benefit) mono pillar scheme to DC (Defined Contribution) pension system is related to financial sustainability. Implementing new pension reform means taking into consideration sustainability and adequacy in the same time.

Key words: pension reform, multi pillar scheme, gender gap

Introduction

The pension system in Albania is running in PAYG (pay-as-you go) basis, where the contributions of current workers are used to pay benefits to current pensioners. This system functions very well when the number of contributors is much higher than the number of pensioners. It is based on the idea that the number of employed persons, consequently the number of contributors will increase with the same ratio of population increase.

The economic transition after 90's brought significant changes in the functioning of pension system in Albania. The labor force pattern changed dramatically. Before 1990, the labor market in Albania was characterized by state controlled and a high degree of centralization. In the early 1990s, the labor market was liberalized; this period was followed by a high degree of unemployment due to the shutting down of major industries and overcrowding in administrative jobs. From the mid-1990s on, there has been a considerable increase in private businesses; however, the rate of long term unemployment still remains high especially among women. Since 1990, Albania has experienced one of the world's largest emigration rates. Almost one-fourth of Albanians left the country after the fall of Communism and most of them are young man. (IOM- Migration in Albania country profile 2008). All of these changes in labor market brought a significant decrease in the number of contributors in pension system.

The main problem that the pension system in Albania is facing now is financial sustainability. Government spent 6.1 percent of the GDP on social insurance expenditure, of which 87.3 percent on pension benefit for 2012. On the other hand the total amount of the revenue in the same year was 4.7 percent of GDP with a fiscal deficit 1.4 percent of GDP.

Literature review

World Bank multi pillar pension scheme

Based on experiences from Chile and other Latin American countries, the World Bank (1994) strongly recommended pension reforms in which traditional PAYG schemes were to be supplemented by private funded system. These reforms consist in three different pillars. The first pillar provides a minimum pension to all pensioners and can be PAYG financed. The second pillar is a privately managed mandatory funded scheme with individualized saving accounts. A third pillar, with a

voluntary private pension, can be added. The idea is to balance the concerns about fiscal sustainability with the desire to ensure adequate pension coverage for most people. The multi pillar approach is seen to provide minimum coverage for all pensioners, while resolving as much as possible the demographic and labor market problem.

The multi pillar pension system consists of the contributory principles, implying a stricter link between contributions paid and benefits received; the raising and equalization of retirement age between men and women and the reduction of early-retirement provisions; and changes in benefit indexation and life expectancy adjustment mechanisms.

NDC schemes

Whereas the multi-pillar personal account systems are based on individual contributions being invested in financial markets, in an NDC system contributions are retained by the state and the financing structure remains essentially PAYG. However pension benefits are determined according to the DC formula, i.e. by the accumulated contributions at retirement. The rate of return faced under an NDC is centrally determined and reflects the formula chosen, whereas under personal accounts returns depend on the investment choices made by individuals and the performance of financial markets. On the one hand, compulsory annuitization and the required use of unisex tables in the NDC pillar, along with minimum pension flat benefits in the safety net pillar, have implicit or explicit distributional effects that favor women. (Holzmann, Palmer, and Robalino 2013)

Design of public pension system

Public pension system in Albania is composed as follow:
- Compulsory Scheme
- Voluntary Scheme
- Supplementary Scheme

- Special State pension

The pension system in Albania consists of two parts: 1) the public obligatory one, which is in Albania the first tier, and 2) the private voluntary part, consisting of institutions of supplementary private pensions, in international comparisons equivalent to the III pension system tier.

Everybody who has a job is obliged to participate in compulsory scheme. Since 2009, the rate of contribution for social insurance is 24.5 percent of monthly salary. The employer pays 15 percent of the total amount of social insurance and the employee pays 9.5 percent. This can be consider as the first tier in the multi pillar pension system.

In the voluntary scheme there participates a person who does not have a job for the moment, but wants to be insured. In this scheme there can contribute even the persons who want to have higher pension income by contributing more in the pension scheme. The supplementary pensions are directly financed by the state budget funds. Employees who have served high constitutional functions, civil and military services are eligible under this scheme. The voluntary and supplementary scheme are third pension system tier.

Special pension regulations are provided for government officials and the uniformed services, but also for miners, pilots and seamen. Those who have reached the pension eligibility age but do not qualify for pension for other reasons are granted social allowance (ndihma ekonomike) paid from the state budget.

Full retirement benefits are paid on reaching the legal retirement age of 65 for men and 60 for women with at least 35 years of contributions and at age of 50 with at least 30 years of contributions for a mother with six or more children older than age 8. Partial pension can be paid from the age of 65 (for men) or age 60 (for women) with 15 years of contributions.

Since it is a Defined Benefit pension scheme, it has solidarity elements between generations, inside the same generation and between genders.

Demographic changes in Albania

Albania, like other Balkan countries, does not suffer from ageing population. It can be still considered demographically young. According to last census, conducted in 2011 by INSTAT, the average age of the population increased from 30.6 years in 2001 to 35.3 in 2011. The old age index, the proportion of the population 65 years and over divided by total population is higher than any previous Albanian census. This value increased from 8 percent in 2001 to 11 percent in 2011. The number of births per year has decreased significantly, from about 53 thousand in 2001 to about 34 thousand in 2011, while the number of deaths per year has remained stable at around 20 thousand. This means a positive natural increase which is characterized by a declining trend of fertility rate. In 2001 the fertility rate (TFR) was 2.3 children per 1.000 women in fertility age and we have a decrease of TFR to 1.69 in 2011 (vital statistics www.instat.gov.al). According to INSTAT data, life expectancy at birth is 76.8 years and the substitution index, the proportion of the population under 15 years old divided by the total population, is reduced from 29.0 per cent in 2001 to 21.0 per cent in 2011.

Although there is an increase in average age and old age index, Albania has still a young population. On the other hand the decrease of fertility rate and increase of life expectancy means that in the next decades Albania will face the problem of aging population.

Gender differences in labor market and the effect on pension income

After the '90s the pattern of labor market changed dramatically. Many of own-stated enterprises closed down, some others reduced the number of employees and at that time the workers have been compensated by the granting of early pensions.

In the midst of these transformations, women found themselves in a more critical position due to their dual burden inside and outside of the household. The transitional period in Albania was characterized by a large vacuum, which brought back traditional law, increased vulnerability of women in the labor market, and deteriorated economic status (Lawson and Saltmarshe 2000). In this new environment, women faced a critical situation since state enterprises, which employed the majority of women, collapsed and so did social protection associated with these jobs. In addition, market reforms increased earning inequalities through wage and price liberalizations, and changed the characteristics of employment (The World Bank 2002).

The unavailability of social protection and economic rights reinforced women's homemaking roles (Tarifa 1994). Consequently, women faced more work within the family, but less mobility and chances to find jobs. With the state stopping child care provision or long paid maternity leaves, women's schedules required more accommodation giving rise to long-term structural discrimination in the labor market (Kligman 1996). With the additional burdens placed on them, women who already during communism, despite their education levels, were in lower occupation and were being paid less, became an easily targeted group for discrimination. According to the results of the last Census data conducted in 2011, man and women have the same average number years of completed education, 10.01

years. On the other hand the participation on the labor market shows many differences between them.

As the table below shows, during 2012, 65.5 percent of the working age population in Albania was active in the labor market. The labor force participation rate of women was 56.7 percent whereas for males 74.4 percent. Compared to the year 2011, the female participation in the labor market has decreased with 3.6 percent while the participation of males has decreased with 1.7 percent.

The employment rate for the population in the age group 15-64 years in 2012 was 56.4 percent. The employment rate for female in the same age group in 2012 was 49.6 percent with a decrease of 2.2 percent compared to 2011. On the other hand the employment rate for males was 63.2 percent or 13.6 percent higher than women.

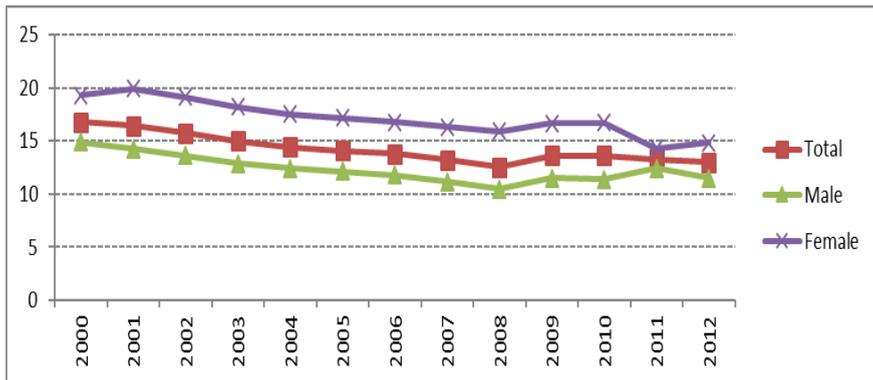| Age	Employment rate		Economically active	
	2011	2012	2011	2012
15-64	58.7	56.4	68.2	65.5
15-29	42.8	35.8	54.5	47.7
30-64	68.1	68	76.3	75.6
Man				
15-64	65.6	63.2	76.1	74.4
15-29	48	40.4	62.1	55.6
30-64	76.6	76.8	84.8	85.6
Women				
15-64	51.8	49.6	60.3	56.7
15-29	37.3	30.8	46.5	39.1
30-64	60	59.6	68.2	66

Source LFS 2011-2012 INSTAT

According to LFS 2012, 50.8 percent of employed females were unpaid family workers, 31.3 percent were employees, and about 17 percent were self-employed without employees. For the employed males, one out of four of them were unpaid family workers and 41.6 percent were employees. According to "Time use survey 2010-2011-INSTAT" women spend significantly

more time than men in unpaid work. Women do 86 percent of unpaid working hours compared to the man 14 percent.

The majority of the employed females work in the agriculture sector. The report of UN-Women and UNDP Albania for "Gender wage gap" in 2011 based on the LSMS 2008 data shows that women's monthly wages in the agricultural sector are about 1.6 times lower than those of men. The unequal rewards for women in the agricultural sector may be due to the fact that they work mainly on family or small scale farms, whereas men might be employed in larger agricultural or agro processing firms extending beyond small scale family farming.

The unemployment rate is higher with females compared to the unemployment rate for men. In 2012 the unemployment rate for women was 14.8, while for men in the same year was 11.5 (instat.gov.al)

Unemployment rate by gender
Source INSTAT

The pension system in Albania is running on PAYG bases and the pension benefit is calculated by the formula:

P = Bp + 1% x N x Wc

N number of contributive years

Wc is the average final salary during last 10 years

Bp Basic pension provides the minimum standard of living and it is DCM (Decision of Council of Ministers)

Since the average wage of women is lower than men's, as per consequence the average pension of women will be lower. According to a survey carried out by *MoLSAEO* "Current issues of third age people in Albania" the average pension of man is 20 percent higher than the average pension of women. Beside this the retirement age for women is 60 years old and for man is 65. Taking into consideration the fact that life expectancy for women is higher than for man, women benefit more than man from DB pension scheme.

The need to reform the mono pillar pension scheme

Before '90s all individuals of working age, male and female, were required to work if able and thus, most elderly have rights in the pension systems and are receiving public pensions. As in many other transition countries, Albania has seen an increased informalization of the labor force, which has led to limited revenue from the payroll contributions while it faces the burden of supporting several generations of elderly, most of whom have full pension rights.

With the growth of the informal sector in the labor market, many of today's working age population are not contributing to the pension system and will not have rights to a pension when they retire. As a result, the pension coverage of the elderly is expected to fall in the longer run, creating additional demands on the government, that of providing some type of old age assistance to the large groups of elderly who have no means of support in old age. According to the financial point of view, in 2012, government spent a total 6.1 percent of the GDP on social insurance expenditure, of which 87.3 percent is pension benefit. On the other hand the total amount of the revenue in the same year was 4.7 percent of GDP with a fiscal deficit 1.4 percent of GDP.

The dependency system ratio (average number of contributors / average number of pensioners) in 2012 was 1.2

(Annual Report of social Insurance Institute of Albania SII www.issh.gov.al).

For all above mention the Albanian pension system is not sustainable from a financial point of view. That means there is a need to reform the pension scheme.

Gender effects of pension reforms

"Inequalities between women and men violate fundamental rights. They also impose a heavy toll on the economy and result in underutilization of talent. On the other hand, economic and business benefits can be gained from enhancing gender equality."[1] Gender inequality is still a reality in almost all policy areas, and in the labor market it is expressed in terms of lower employment rates, higher unemployment rates and a gender pay gap that results in lower incomes for women both during their working life and after retirement.

The link between pension benefits and past contributions has been reinforced with the shift from defined benefit to defined contribution schemes. Persons who contribute more during the working time will benefit more. As it is said in the section of labor pattern:

- women are more likely to be low wage earners;
- women are more often in part-time employment, and
- women are more likely to have interrupted employment records.

Actuarially fair insurance systems, like those envisaged in contribution based systems, compare an individual's lifetime contributions with the individual's expected life-time benefits.

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[1] European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic And Social Committee and the Committee of The Regions - Strategy for equality between women and men 2010-2015 Brussels, 21.9.2010 COM(2010) 491 final

Since the life expectancy of women is higher than that of men, actuarially fair insurance means that women must have either higher contribution rates or lower pension benefits than men.

In defined benefit (DB) schemes the link is weak and usually low earners have higher replacement rates than high earners; in defined contribution (DC) schemes the link between contributions and benefits is strong. For this reason DC schemes are less favorable to women than DB ones.

Conclusions

Pension is the main source of living for people in old age. Financial sustainability is very important to maintain the pension system, but the main objective of social security is to alleviate old age poverty. Reforming the pension system must take into consideration both sustainability and adequacy.

Implementing a multi pillar pension system will have a gender impact. It depends on detailed design features of these reforms. The first pillar, which is a public one and DB scheme are particularly important to older women. Indexation provisions in this pillar determine whether the old women will benefit from pension system. Strengthening the role of the first pillar should be a priority in the process of reforming the pension system.

Equalizing the retirement age means an increase of contribution paid during the working time into the pension account. This will diminish the gender gap in monthly pension.

In DC pension plans the individual decides where to invest the pension savings. The individuals often have limited financial knowledge, and in particular know little about the characteristics of their pensions, including how much to expect (and how much they need) in retirement benefits. That happens because learning about pension is difficult and, therefore, the risk is an individual responsibility. For this reason individuals have to be clearly informed of the options available and the

associated risks. It is important to organize a public awareness to support them in improving their financial literacy level in order to be able to make decisions.

Pensions policies alone cannot, however, reduce gender differences in pension income, as they largely reflect gender gaps in the labor market. For this reason it is important to improve the incentives for women to access the labor market.

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