

## The Future of Social Security System in Albania

AURELA BRAHOLLI

Phd Candidate, the Albanian Security System Institute  
External Lecturer, Academy of Business University  
Albania

### Abstract:

*This paper will be focusing on the recent developments of the Albanian system of Social Security System. It will be divided in three parts. Firstly will be a quick run through the history of Social Insurance developments to understand how the actual models adapted in different countries in Europe. The second part will talk about the Albanian Social Security developments through centuries up to actual system and analysing the current system. By projecting the future within the frame of the actual system and the trend of the actual data, we will analyse with effectiveness of the actual Social Security System in Albania. The analysis will indicate that for the next 10 years, the expenditures will increase more than the inflows and the deficit created by the actual scheme will increase in 2.2% of Albanian GDP. The last part will be focused on conclusions, suggestions and ideas on how to change things in Albania and how to make it better.*

*The main reason of this analysis is to understand the system and to evaluate the reforms and their effects in the Social Security System in Albania after having done many researches on web, journals and text books. By creating a clear picture of the situation will lead to different conclusions and suggestions as how efficient the system is and what should be done to make it better.*

**Key words:** Albania, Social Security System, PAYG, Pension, Forecastings.

## 1. INTRODUCTION

Albania, as many countries of Communism Block, changed its governing system after 1991 into a Parliamentary Republic. This change brought the new constitution which affected many aspects of the system. The objective is to describe the changes in the Social Security System (S.S.S.) of Albania, as a very important topic concerning the society members of Albania.

From the Soviet System of social care Albania moved into the “Pay AS You Go- (“PAYG” ) model which is still effective up today. Obviously this change was reflected in the behaviour of the society and the rapport between contributors and benefiteres worsened. There was a drastic change in the country where many became unemployed, many were in immediate need for financial care in various forms (retirement pension, invalidity, special pension etc.)

The need for an efficient social care system was immediate to have for the new democratic republic which was suffering the transition effects. In 1993 the law was passed in the Parliament and that was the start of a new era. Since then Government amendments and other injections have been taking place in order to achieve an efficiency and consistency.

Before analysing the system in Albania it is important to know what we mean by Social Security. How did it start? Why is it so important to offer such a service to the society? What are the different models implemented around the world? To answer all these questions it was necessary to consult many text books, web-sites, journals and other publications.

Right after the Second World War, the bill of Human Rights was created. In the 22<sup>nd</sup> article of the “Declaration of Human Rights 1948” it is stated:

“Everyone, as a member of society, has the right to social insurance and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each State, of the economic,

social and cultural rights indispensable for his dignity and the free development of his personality.”

Article 25 of this declaration goes further on ensuring living standards for everyone.

This is the main function of the S.S.S. It ensures that all the members of the society, active working force or not, disabled or not, is supported financially by a fund managed by either public or private institution in order to secure for them the minimum standards of living.

Firstly the term “social security” was mentioned in Germany by the end of 19<sup>th</sup> century and that was the foundation of the modern systems applied around the Globe.

German chancellor Otto Von Bismarck (1862-1890) was the first who introduced the first law on social securities in 1883. This law was formulated to insure employees in case of illness. The law was followed by others (1884 – Law on Injuries, 1889 – Law of Retirement and Disabilities).

The beginnings of social security model in Albania are noticed during the ruling of Ali Pasha Tepelena who lived during the years 1740-1882. According to the studies of Mr. Fadil Kepi (known for his expertise in the Social Security System of Albania, former director of the Albanian Institution of Social Security), first pensions in Albania were distributed by Ali Pasha in the late 18<sup>th</sup> century toward the teachers.

The first legislation in Albania is dated in 28<sup>th</sup> October 1927 known as Law No. 129 on Civil Pensions. Article 7 states that the right to benefit from this scheme is attributed to all those officers of civil administration active from 28<sup>th</sup> November 1912.

Right after the Second World War, 25<sup>th</sup> Aug 1947, the law on pensions was formulated by the Communist Party governing at that time. Whereas in 1966 was formulated the full legislation which was effective until the fall of the Communist System. The whole social security system of this time was based on the Soviet system, a system that

characterised all countries of the Communist Block. Based on Bismarck model, the Soviet model was evolved and mainly based on the full employment of the members of society who would contribute in the development of the country. This development would generate enough income to cover the insurances paid to pensioners, disables and other groups entitled to benefit.

Political, economic and social changes that occurred in 1991 had crucial impact on the Albanian system of Social Security. The unemployment was so high due to the destruction of public entities like factories and organisations. Many people had no second source of income. This brought a very low number of contributors in the budget of the government for social security.

Many other people who had suffered from the regime were entitled to special pensions and many others to compensations. The number of benefiteres from social security was drastically increased and there not enough funds to cover these expenses. Syndicates were putting constant pressure on the government to concede retirement pensions before the retirement age which was 55 for men and 50 for women.

The rapport between contributors and benefiteres by the end of 1993 was 0.75. This rapport was 4 in 1990 (i.e. 4 contributors for 1 benefiter). The number of people who were entitled by the end of 1993 was 470.000. This number of benefiteres was only 320.000 by 1990.

### **a) Actual system**

All these changes and problems caused by the transition of the political and economic system urged the need to come up with a new law that would reconstruct the whole social security system and would ensure the minimum requirements to meet the living standards of the Albanian citizens. Hence, on 11<sup>th</sup> May 1993 the law on Social Security was passed in the Albanian Parliament. This is the law that is still in power and

on which the whole actual system of social security is built in Albania.

### **b) Pensions**

The actual system is divided in 2 different columns: 1- Compulsory pensions and 2- supplementary pensions.

When we talk about compulsory pensions, we refer to retirement pensions, disability pension and family pensions. The range of groups benefiting from these schemes is quiet large. The level of pension conceded to specific groups depends on many factors (employment status, years of working, profession). All these factors have experienced the effects of recent demographic changes (migration and emigration), privatization of public entities, movements toward self-employment and changes on the criteria's of getting entitled to pensions. Main weight of expenses on pensions by the budget is focused on retirement pensions. It is important to not the last statistics which indicate that the average age of Albanian is getting older. This infers that the group age of pensioners who benefit retirement pensions is increasing.

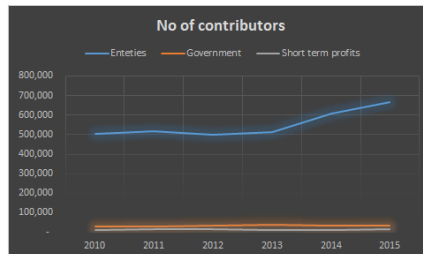
### **c) Budget**

There is a special budget to ensure these insurances. This budget is independent to the government budgeted and is managed by the Albanian Institution of Social Security. There are 5 different categories in which this budgeted is split: Illness, injuries and related illnesses to the profession, pensions and unemployment and birth allowances. Each category has its own assigned budget and no transfers are allowed among them. The funds can be exchanged in forms of loans only. Over 80% of this budget is filled by the government. The rest inflows came from third parts and contributors. The government injections of funds occur in order to pay pensions and other insurances, cover inflation effects and to increase the level of pensions and insurances time to time depending on economic and social situation.

This budget is reviewed annually and in total recordation with the Ministry of Finances. It is important to review all micro and macro elements in deciding the usage of this budget. Sometimes, government injects considerable amount of money in this budget in order to cover all the specific categories of people in need and other projects related to government strategies. And for political propaganda this element is promoted as a very positive factor that fights poverty. But this is not always the case. Lack of transparency and adequate control over the expenses of the budget, derives the funds away from targeted groups and makes it useless and inefficient.

Other problem seen in the inflows of the budget is the level of contributors. The level of actual contributor and the level of real potential contributors is misbalanced and negative for the budget. Actually this is a phenomena experienced in all countries in transition. The marked diverted from concentrated economy during the communism into open market economy. Unemployment was increased together with the informal market. Due to the high level of contributions payable to the fund and poor economic situation to secure enough funds has pushed many entrepreneurs to avoid these contributions. Hence the budget is always struggling to cover the minimum requirements for the projected expenses. There was a tentative of the government to reduce the percentage of the contributions in 2002 by amending the 1993 law. Nevertheless this rate of contribution stays high and the level of evasion by contributors is concerning for the government.

**Table 1: No of contributors**



Source: Author

The chart above shows the number of contributors along the years and which in 2015 goes beyond 700,000 contributors. The only contributing group that has experienced major changes is group of entities. This group is compound by organisations and individuals with different legal status on operating in the market. Recently are added rural contributors from the village who are volunteers. This is due to the reform of the government to equalize the pensions of urban and rural contributors by increasing the contribution of the last ones. New government which has come in power in 2013 has undertaken serious steps in formalizing the market, easing taxation on small businesses and has implemented subventions for a good part of this group. At the same time has created a positive and sustainable situation which comforts the entrepreneurs and encourages them to pay their dues and declare their activity almost 100%.

**-Distributions of funds.** Government is always responsible for the wellbeing of its people and has to avoid the possibility to let them suffer. For this reason the government has to make sure to distribute security funds to elders, disables and those who are in need. Liebman has gone thoroughly in 2001 when he emphasizes the obligation of the government to do so.

The distribution of these funds goes through three channels: 1- Young to elders, 2- rich to poor, 3- men to women. With an overlook of all these channels of distribution we see something in common, distribution between generations. Only a system like PAYG could make this distribution effective. When youth pays contribution to pay the pensions of their parents and grandparents it is not just an obligation imposed by the government, but even a moral obligation as those parents have invested on their children their whole life. The positive aspect of PAYG in terms of distribution between poor and rich is that the pension benefited is the same regardless the wealth status enjoyed before retiring. Women are tended to work less and in low profile positions compare to men especially in a patriarchal country like Albania.

Financed systems do have an opened window that allows distribution of funds, but it will never be as efficient as PAYG system.

**-Administrative fees.** The level of pensions is highly affected by the administrative fees occurred during the process of calculating and administering the funds of pensions. Diamond in 1993 has gone through a thorough study in order to appoint which of the different methods is more efficient and less expensive. Methods like in Malaysia, Chile and Australia have proven that private funds and financing methods are more expensive. Whereas a PAYG system uses the advantages of the economy of scale to reduce the costs and decrease the effect on the level of pensions. In Albania pensioners are very sensitive to every dime of their pension. An expensive system that would reduce the level of pension would be unacceptable in this country. People are already struggling.

## **2. ANALYSIS**

In this analysis we will take in consideration a projection for the next ten years of the actual module of PAYG. Based on this assumption and some actual data, we will judge whether the actual security system in Albania will improve the annual deficit which equals 26 billion Lek (approx. 260 million \$) or will increase it. This deficit made 1.82% of the GDP in 2015 and so far has been covered by the government funds. In order to achieve such conclusions, we have used data provided by INSTAT (Statistic Institution – Accounted only to the Council of Ministers) and from ISSH (Public Institution of Social Security).

Active labouring force in Albania of the group-age 15-64, in accordance to the official data, is 2,005,138 people. Only 35.8% of this total pay contributions.

During the last 10 years, from 2005 until 2015, the number of contributors has increased by an average of 12,000



contributors a year. Therefore, we have projected that for the period of time 2016-2025 we will have a positive tendency of the number of contributors which will increase by an approximate 15,000 contributors a year. At the same time we have assumed that the economic growth of the country will be by 3% and the inflation will have an average level of 2.5%.

Based on the assumed progressive growth of contributors in the next 10 years, we will have by the end of 2025 a total amount of contributions of 118 billion Lek or 1.18 Billion \$.

This total is assumed to be true in the scenario that the legislation on compulsory contribution will not change for this period and we will have an indexing of the contributions in accordance to the inflation.

**Table 2: Structure of Revenues**

Year	Revenues ALL	Rev per person ALL	Contributors
2015	763340	1063	718.000
2016	797368	1090	731.714
2017	832912	1117	745.690
2018	870042	1145	759.932
2019	908826	1174	774.447
2020	949339	1203	789.239
2021	991658	1233	804.313
2022	1035864	1264	819.676
2023	1082040	1295	835.331
2024	1130275	1328	851.286
2025	1180660	1361	867.546

Source: Author

Table 3 below shows the level of expenditure for the next 10 years. Notably we see a much higher level of expenditure by the end of 2025. It means that without a higher buying potential of the budget destined for the pensions (up to 70%) and a much better legislation, *ceteris paribus*, this increase will bring the pension per capita from \$170 to \$220 and the number of pensioners will increase from 598,000 to 792,000 pensioners. In overall the level of expenditure by ISSH will be up to 173 billion Lek or 1.73 billion \$. This projection is conducted by INSTAT.

**Table 3: Structure of Expenditures**

Year	Expenditures ALL	Pension per person	Pensioners
2015	1024170	17127	598.000
2016	10796928	17555	615.043
2017	11382257	17994	632.572
2018	11999317	18443	650.600
2019	12649830	18905	669.142
2020	13335609	19377	688.213
2021	14058566	19862	707.827
2022	14820716	20358	728.000
2023	15624184	20867	748.748
2024	16471210	21389	770.087
2025	17364155	21923	792.035

Source: Author

The deficit created by the actual scheme, as shown in Table 4, will increase by reaching concerning levels of 55.5 billion Lek or 555 million \$. This level of deficit will be 2.2% of the GDP in Albania for 2025. The nominal value of increase will be 5.5% of which 3% is real increase and 2.5% is the inflation predicted for that period.

This deficit will have to be covered by the taxation income in Albania because on top of the contributions inflow, the tax-payer will have to cover a deficit of 555 million \$.

It is so obvious that the Albanian Government has to intervene by improving the actual Social Security System. This system has to be and must be more meritocratic and aim the abolition of the deficit.

**Table 4: Structure of Deficit**

Year	Deficit	PBB	Def/PBB %
2015	260830	14770000	1.81%
2016	282325	15582350	1.81%
2017	305313	16439379	1.86%
2018	329890	17343545	1.90%
2019	356157	18297440	1.95%
2020	384222	19303799	1.99%
2021	414198	20365508	2.03%
2022	446208	21485611	2.08%
2023	480378	22667320	2.12%
2024	516846	23914022	2.16%
2025	555756	25229294	2.20%

Source: Author

### 3. CONCLUSION AND RECOMMENDATIONS

After having analysed in general the social-economic development in Albania and legislation on Social Insurance System in specific, we have noticed some issues. These issues mainly refer to the compulsory pensions and should be in the focus of the government to improve and develop it further.

Some of the problems are as listed below:

- By increasing the number of pensioners, increases the risk of financial crises in the future as the coverage of the expenses is insufficient.
- High level of informality brings low levels of contribution and high levels of invasion.
- For the next 10 years, based on our projection of 15,000 contributors increasing year by year within the same system applied, the inflows will increase by 54.6%. From 763million \$, the income from the contributor in 2025 will be 1.18 billion \$.
- The number of pensioners is expected to increase by 19,400 persons each year. This will increase the expenditure by 69.5% from 1.024 to 1.736 billion \$.
- The analysis indicated that if continued with the actual PAYG system the deficit will increase from 260 million \$ in 2016, to 555 million \$ in 2025. The deficit will be covered by the funds of the government and it will make 1.82% of the GDP in 2015. Whereas in 2025 the deficit will make 2.2% of the annual GDP.
- Government has been active in improving the system. They are aware that much more need to be done. Even though there are concrete commitments of the government to improve the system, the necessity of continuous reforms, improvement and amendments in the actual law is always present. The dynamic of social – economic situation, reflects on this need to change the law and the scheme.

- Perhaps splitting and importing in another scheme several payments such as maternity leave, disability and veteran's pension will improve the deficit. Alternative schemes have to be taken in consideration with the sole intention to sooth the deficit created by the actual system of pensions.

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