Abstract

This article analyses the reforms in the pension scheme in Albania during the transition period. An analysis of changes experienced by the performance of the social insurance scheme reveals that, so far, the system is almost entirely dominated by the public scheme “pay as you go”, which for the moment is facing serious challenges. The results of the prognoses show that these problems will accompany the scheme in the future too. Under these circumstances, it can be inferred that, in addition to the application of parametric modifications to the public scheme in order to strengthen its financial stability, the initiation of a more radical reform in the pension system is becoming crucial. The paper concludes with some recommendations on how to carry out the reform of the public pension scheme and it proposes the introduction of a multicolumn pension system.

Keywords: Pension funds, parametric reforms of pension funds, performance of social security system, dependency ratio.

JEL classification: G230

1. INTRODUCTION

Social insurance plays a basic role in the social protection scheme of the population. In 2008, 534 thousand pensioners benefited from social insurance. We believe that its role will continue to rise. The benefits offered by social insurance in 2008 were 61.6 billion Lek ($64.8 Billion). This amount is approximately 5.37% of the GDP and 71% of the social protection scheme cost. The benefits are divided as follows: pensions, insurance in case of illness, insurance in case of accident and professional illness, insurance in case of pregnancy
or birth, insurance for unemployment payments. Among them, the central position is held by the branch of pensions, which allocates over 97.6% of social insurance benefits.

During the past two decades, the public scheme development was conditioned by the problems of transition. In 1991, when Albania began the transition from a centralized economy to a market economy, it inherited a very difficult and problematic economic situation, with: negative growth rates; profound lack of products in the market; rationalization of basic alimentary products; rising inflation; unemployment (at first secret than declared); decline of population income; etc.

During the first years of transition the situation deteriorated rapidly. Competition made it impossible for production capacities to continue, since outdated technology was still being used widely. GDP in 1991 was 27% lower compared to the previous year, while in 1992 the decline was even greater, reaching the amount of 33.2%. The economy faced records of hyperinflation. In 1992, inflation reached the rate 237%, accompanied with a fast depreciation of the currency. The budget deficit increased as much as 60% of GDP, and the unemployment rate rose to 27%. The old governance structures were abandoned in a time when market institutions were still inexistent, which caused the situation to worsen.

During the period 1991-1994, because of the economic collapse, the active population was employed and the amount of contributors to social insurance was drastically reduced. In 1994, there were only 480,435 contributors to the pension scheme, from 1,451,212 in 1990. In the rural zones, after 1992, the year of definitive closure of agriculture cooperatives, there were only 7.6% of the contributors of 1990. The high level of unemployment, deep social tensions, and syndical pressures forced politicians to legalize a premature pension scheme. This provoked an atypical rise in young pensioners, where a 45-year-old teacher, for example, could benefit from this scheme.

As a result of the serious reduction of contributors and fast increase of beneficiaries of social insurance scheme, dependency rates worsened. The figures changed from 45 beneficiaries per 100 contributors in 1990, to the critical level of 104 beneficiaries per 100 contributors in 1994. The implementation of a new scheme that would prevent the situation to collapse, would deal with emergent problems caused by the serious developments of the period and would resist time as much as possible, was another factor which influenced the scheme reform.

The process of pension reform in Albania was achieved in two ways: 1. through reformation of legal framework; 2. through adoption of parametric reformations.

During the first years of transition, Law no. 7703, of 11.05.1993, “Social insurance in the Republic of Albania” was drafted and implemented. The Law aimed the replacement of the old pension scheme, which, in essence, was more a type of social help scheme, with a mandatory public scheme with PAYG benefits. In accordance with market demand, this scheme would be financed through employers and employees’ benefits and would guarantee the fulfilment of social-economic rights in the field of life insurance secured by Law, and reported in International Convents.

After the reformed scheme went into effect, it exposed deficiencies in the legal framework and undesirable trends in the adoption of the scheme. In order to avoid these deficiencies and constraints by the deteriorating trends of the financial situation, several partial reforms, for the modification of some parameters of the scheme, were undertaken. The parametric reforms package included reforming the rural scheme; increasing the pension age; raising the minimum wage; increasing the proportion maximum wage/minimum wage;
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reducing the amount of contributions and unification of pension accorded before 1993 with
pensions accorded after 1993.

In Albania, unlike most other transition countries, where pension reforms for the re-
structuring of the existing scheme toward a multicolumn structure, including
implementation of obligatory pension schemes with appointed contributions and reservation,
the reform didn’t imply the need of setting up a pension pillar based on a funded scheme.
Thus, the pension reform process is not finished yet.

This article focuses on the reform of the pension system in Albania. It is organized in
these sections: Section 2 analyses the existing situation and the reformation of the perfor-
ance of the public PAYG scheme, which for the moment dominate almost entirely the
pension system; Section 3 analyses the situation of supplementary schemes of private
pensions and the reasons for their low development; in the last section conclusions and rec-
ommendations are provided concerning the necessity of a radical reform in the pension
system.

2. THE PERFORMANCE OF THE PENSION PUBLIC SCHEME

We will first analyze the development in the public scheme. Thereafter, we will ex-
amine developments in private schemes. We will consider two periods in our study: tran-
sition period (1994-2008) and prospective period (2004-2075). We will use statistical
published data, and data from prognostic studies.


The performance of the scheme during this period can be analyzed in two ways, de-
pending on the year that will be used as reference. We will use as reference-year the year
considered as the start of the transition period. There are different opinions regarding this
matter, one opinion considers 1990 as the reference year, and another considers 1994. 1990
is the year when the market economy began, while 1994 is the year when the reformed
pension scheme started functioning. The conclusions of these two different lines of study
differ considerably from each other. According to the first line of study, results show that,
during the period 1990-2008, the performance of the scheme did not improve, since the year
after year variations contributed only to recover the real pension level of 1990. According to
the second line of study, the situation is completely different. The result of the performance
of the scheme has improved, since the real pension level, during the period 1994-2008, has
increased.

The difference of two studies is caused by the 1990-1993 period. In these years, be-
because of the deterioration of the macroeconomic situation and decline of the scheme, the real
pensions experienced negative effects. During the period 1993-2003, the average pension of
the urban scheme, for example, was three times lower compared to that of 1990. Even
though, as mentioned above, the transition toward market economy began in 1991, we will
use as reference year 1994. We are using this line of study because Law no. 7703, which re-
formed the public scheme, went into effect after October 1993.

The variations of the main indicators of social insurance scheme during 1994-2008 are
shown in Table no. 1, while its analytical indicators are presented in Table no. 2.
The review of these indicators and macroeconomic indicators of the period 1994-2008, confirms that the performance of the scheme didn’t follow the desirable direction. According to the direction of performance indicators, the entire period can be classified in three phases:

- **First phase (1994-1996)** The macroeconomic parameters were optimistic and the performance of the scheme was improving. During this phase: the scheme cost indicator as a fraction of GDP was rapidly increasing; revenues were increasing faster than costs; the scheme deficit was decreasing. However, this improvement came mainly by scarifying the interests of pensioners, because the replacement rate and the real pension remained low and even decreased during this first phase.

- **Second phase (1996-2002)** This phase started with the problematic events, regarding the year 1997, when the macroeconomic improvements were interrupted because of the bankruptcy of pyramidal firms. But, after the collapse, the macroeconomic situation improved: the annual average increase of GDP was 8% and inflation and unemployment rates decreased. However, the performance of the scheme during this period declined in several directions: costs increased faster than revenues; the rate of replacement fell; real average urban pension increased only by 8.8%; etc. Even though the dependency rate declined slowly, it remained in very high levels for Albania.

- **Third phase (2002-2008)** The economic situation is considered favourable. The inflation rate is stabilized in levels 2-4%. The unemployment rate is declining, even though a slow decline in the growth rate can be noticed. Although the contributors increased by 51.4%, the beneficiaries declined by 3% and the dependency rate of the scheme declined significantly, the performance of the scheme worsened even in this phase and this was reflected in its financial result.
• From a review of the scheme performance for the period 1994-2008 it can be inferred that some improvements are achieved, but they are almost insignificant. The population coverage from the scheme increased to 2.2%. The costs as a fraction of GDP increased by 1.8%. Revenues increased more than costs, respectively 7.14 times and 5.87 times. The dependency rate declined considerably, by a rate of 27%, or from the level 96 beneficiaries per 100 contributors in 1994 to 70 beneficiaries per 100 contributors in 2008.

Even though the dependency rate declined considerably, the financial result of the scheme did not experience these optimistic levels. In fact, the deficit of the scheme decreased only by 732 million Lek, or 1% of scheme costs in 2008. This deviation came because the dependency rate decreased only in the rural scheme, while the dependency rate in the urban scheme increased by 24%. Additionally, in the rural scheme, contributions of farmers are much lower compared to contributions of the self-employed in the urban area.

The performance of the urban scheme has relatively worsened compared to the performance of the rural scheme. The dependency rate in the urban scheme increased from 71 beneficiaries per 100 contributors in 1994 to 88 beneficiaries per 100 contributors in 2008, while the same indicators in the rural scheme declined from 362 to 54 beneficiaries per 100 contributors.

Comparing the main indicators of the public scheme in Albania with the same indicators in neighbouring countries, shows that the situation of the public scheme in Albania is inferior. The revenues of the scheme in relation to GDP are 5.7%, while in neighbouring countries this rate is between 8-10%. The dependency rate is at a critical level: 74 beneficiaries per 100 contributors. The difference between minimal pension and maximal pension in Albania is very low. The maximal pension is approximately twice the minimal pension, while in other economies this difference is more than threefold. Moreover, during the period 1994-2002, this difference dropped below the official levels. Because of the unequal indexation of pensions, where increasing minimal pension is the priority, the proportion maximal pension/minimal pension has declined, reaching in 2002 the critical level 1.27 to 1.

The public scheme generally offers low benefits compared to the high level of contributions and the benefits in neighbouring economies. Even though during the period of 1994-2008 the average nominal pension in the urban scheme increased 3.6 times, this achievement is due to the low level of pension in 1994, which was only half the real pension in 1990. Thus, the increase compensates only the inflation rate and helps to recover the real pension level of 1990. Additionally, during the 14-year period, the average real pension in the urban scheme, which determines the standard of life of the pensioner, increased insignificantly, only by 10%. This shows that the public scheme for the moment does not have financial capabilities to increase the benefits of the pensioner, which are at very low levels. The average urban pension is 9,831 Lek (72 Euro or $103). The rural pensions are even lower. These low levels of benefits caused the standards of living to decline for pensioners. Moreover, they weakened the relationship that should otherwise exist between contributions and benefits, and encouraged evasion in collecting contributions.

Comparing the dynamics of pension and wages, it can be inferred that the increase of pension has always been much slower than the increase of wages. For the period 1993-2002, for example, the average wage increased 3.57 times, while the average real pension increased only 2 times. Thus, the replacement rates gravely worsen in both urban and rural schemes. The replacement rate for the average urban pension declined from 70% in 1990 to 60.2% in 1994 and 48% in 2008. Moreover, the low level of this indicator is in total discor-
dance with the replacement rate of 75%, set by Social Insurance Law. The replacement rates of rural pension have been constantly lower than urban replacement rates. In 1994, the rural rate was 27.3% and it has declined through the years, reaching the level 15.7% in 2000. After that year, because of higher rate of increase of rural pensions compared to minimal wage and contributions, the replacement rate of rural pensions begun rising, but still it remained at very low levels (26.9% in 2006).

The dynamics of real pension compared to the analysis of the replacement rate show that the public scheme has not been able to provide an increase of living standards of pensioners and that the current financial stability has been guaranteed by sacrificing the interests of pensioners.

The analysis of the performance shows that the public PAYG scheme is constantly facing problems and difficulties in order to guarantee financial stability.

2.2. FACTORS THAT AFFECTED THE ACTUAL PERFORMANCE

The economic situation of the country and its developments are the main factors that affected and conditioned the performance of the scheme. Some factors that help to understand the problems and challenges of the reformed public scheme in Albania, after 1993, are: the serious deficiencies inherited from the previous period; the low and instable economic development during the transition period; the high level of unemployment and poverty; the high level of trade deficit with increasing tendency; etc.

Since the public PAYG is a non-funded pension scheme, its ability to cover financial obligations for the pensioners depends from the aging structure of the population, previous experience of the scheme, and the macroeconomic performance of the country, especially in terms of employment rate and ability of tax structures to collect contributions. The PAYG scheme would suffer of immaturity or deficiency in financial balance, if the population of the country is old and the economy declines. In these cases, the scheme faces financial difficulties, or inability to pay contributions. In order to achieve financial balance, some extreme action has to be taken: the rate of contributions has to be set at high levels; the pensions should remain unchanged or increase in very low levels; the replacement rate has to decrease; the subventions from the state budget have to increase. These actions were undertaken during the period of reformation of the pension scheme.

The public PAYG scheme, in most of European countries and in many other countries, is facing the demographic challenge of population ageing. It has been some time now that the natural population increase has declined, or, even worse, has experienced negative values. Moreover, due to achievements in medicine and improvement of standards of life, the longevity of the population has increased compared to past periods. The combination of these two factors in these countries has caused the problems and challenges related to population aging. This phenomena cause the faster increase of amounts of pensioners compared to contributors, thus worsening the dependency rate of pensions. When the dependency rate reaches its critical levels, the budget of the scheme results in deficit and the financial pressure of the public scheme to the state budget becomes serious to the point that the continuity of the PAYG scheme is questioned.

In Albania, as in many other countries, the high level of dependency rate in the public scheme is becoming a serious problem. In most other countries, the high level of dependency rate results from population aging. In contrast, Albania is a young country, thus the high level of dependency rate can be explained only partially by the aging population trend.
The particularity of the public pension scheme in Albania is that the difference between the dependency rate of pensions (defined as the ratio of beneficiaries to contributors in the scheme) and dependency rate of old population (demographically defined as the ratio of over 65 years old population to working population between 15-64 years old) is very high compared to other countries with an aged population.

To identify the factors that affected the high level of dependency rate in the Albanian public scheme, we need to review the relationship between dependency rate of pensions (Nvs) and dependency rate of aged population according to demography (Nvd).

\[ N_v = \frac{\text{Beneficiaries}}{\text{Contributors}} = \frac{\text{Beneficiaries}}{\text{Population 65+}} \times \frac{\text{Population 65+}}{\text{Population 15–64}} \times \frac{\text{Population 15–64}}{\text{Contributors}} \]

The equation shows that the dependency rate of pensions depends on three factors: level of aged population covered by the scheme (beneficiaries/population 65+); dependency rate of aged population (Nvd); and level of unemployment (population 15-64/contributors). Since the dependency rate of the aged population (Nvd) is more than 6 times lower than the dependency rate of pensions (Nvs), it is obvious that the factors that affected Nvs are the level of the aged population covered by the scheme and the unemployment rate. These factors depend directly on the conditions of the labor market.

The actual situation of the labor market remains distant from normal parameters and is affected by problems and challenges of transition. The entire aged population benefits from the public scheme. Moreover, there was a period of time, where the number of beneficiaries was higher than the number of the aged population that, by Law, could benefit from the scheme. This was also caused by special types of pensions and other factors that affected the scheme, such as: premature pensions; young retirement age of women and employees classified to work in difficult jobs; incomplete procedures of timely elimination of pensions of those who died from the scheme; etc. Even though the entire aged population benefits from the scheme, a large number of working population does not contribute to the public scheme. This is caused by the high rate of unemployment, which for the moment is officially declared 12.8%. But, the actual unemployment rate is even higher, if we consider: the large number unemployed citizens not registered in employment offices; migration tendencies, and the high rate of informality in the economy of the country and especially in the labor market, which also contributes in evasion in collecting contributions for the scheme.

Another feature of the public pension scheme in Albania concerns the low level of average income per person of the population. Other countries with aged populations in Western Europe and Japan have relatively high national income, and consequently bigger capabilities to allocate more benefits for the elderly, without reducing investments, which is a main factor of economic growth. However, this is not possible for Albania, where the increase of the dependency rate happens in the conditions of insufficient national revenues to support the needs of the sectors of education, health and infrastructure. Consequently, the state budget does not have the ability to allocate sufficient benefits for the aged population. For the above-mentioned reasons and other reasons related to economic and demographic trends, the level of pension expenditures in Albania, for the moment, is much higher in relation to national income.
2.3 THE PERFORMANCE FOR THE PROSPECTIVE PERIOD 2004-2075

With its importance, the analysis of the current situation of the scheme is only one side of the story. The future performance could be different from the current one, because the problems of the transition period, which affect the current performance, could be avoided and, therefore, would not affect the scheme in the future.

The study of the prospective performance of the scheme is conducted through well-known prognosis techniques. Since the explanation of these methods is not an object of this article, we have reviewed and utilized the results of a study conducted by World Bank (2006)\textsuperscript{iv}, moreover, we have consulted a study of the Albanian Social Insurance Institute (2006)\textsuperscript{v}.

The World Bank study, utilizing the PROST model, makes projections about the population, numbers of contributors and beneficiaries of the system, their annual contributions or benefits, respectively, and the overall financial outcome of the system. Projections depend heavily on assumptions that the demographic and macroeconomic developments would remain constant in the future.

Albania is in the position of being a young country with population projected to grow throughout the simulation period. Population growth will, of course, slow down, but will remain positive throughout. Nevertheless, the share of the population above retirement age will rise markedly from the current 11.6 percent to 25 percent in 1975. The dependency rate of old age population (Nvp) will rise commensurately starting from 2012. This indicator, for the entire simulation period, is projected to rise from 20 people over the pension age per 100 people in working age to 45 per 100. This forecast shows that even though Albania is a young country, the public scheme will eventually face the challenges of population aging.

In both the rural and urban systems, the system dependency rates initially fall in response to the rising retirement ages. Once the pension age reform is fully implemented, the rates begin to rise again. In the rural system, the rate increase continues until the end of the simulation period, while the urban system sees rates falling slightly after 2050. The prognosis of dependency rate is based on the assumption that the current rural scheme will transform and the farmers will pay all the contribution for the scheme. If this does not happen, then the dependency rate may rise significantly and at the end of simulation period it may reach the critical level of 130 beneficiaries per 100 contributors.

The dependency rate has worsened as a result of the low proportion of contributors relative to the working population at just 58%. This will cause the number of elderly with rights to the pension system to start falling after 2050, as the people with incomplete contribution histories begin to retire. Projections show that the scheme will be faced not only with the increase of dependency rate, but also with the increase of aged people that will not benefit from the mandatory scheme. Thus, in the future, the scheme may create a social problem related to the management of the elderly that will not benefit from the mandatory public scheme. These people will represent 40% of people that have reached retirement age.

A very important matter in the evaluation of future scheme performance is the forecast related to its financial outcome. The projections for this indicator are prepared in two scenarios: the first scenario relies to the current Law, according to which the pensions are indexed using the \textit{customized pensioner price index}, while the second scenario implies the replacement of current Law and the indexation of pensions using the average wage variation. The result of prognosis shows that these scenarios affect the financial outcome of the scheme in different ways.
According to the first scenario, the financial outcome will eventually improve, making possible also the achievement of the policy for reducing working tax in the future. On the other hand, the replacement rate cannot be politically supported, since beneficiaries and consummation rate would seriously decline. Consequently, along with the reduction of benefits, the motivation to contribute in the public scheme would weaken.

According to the second scenario, an opposite situation would arise. The beneficiaries from the pensions indexed using wages are much higher. This is shown through the replacement rate, which remains at the level 40% for the average urban pension at the end of the simulation period. In the meantime, the financial stability of the scheme will weaken. The total deficit of the public scheme at the end of the period will be 0.4% of GDP.

The simulations of the two scenarios show that during the period the actual public scheme is not capable of guaranteeing the decline of contributions and, in the meantime, the required levels of benefits.

When pensions are indexed using inflation, the financial balance stability of the scheme is guaranteed, but the replacement rate and real pension decline. This situation doesn’t motivate the employees to raise contributions. Moreover, it encourages evasion in the scheme affecting the decline of income and its financial instability. If the benefits would be indexed using the wages increase, the existing scheme would guarantee benefits in the base level as defined by International Labor Organization (the average replacement rate of 40%). But, in this case, the scheme will be financially unstable. Under these circumstances, making a middle ground choice between the scenario of indexing using inflation and the scenario of indexing using wage increase would be the more rational choice during the review of the existing PAYG scheme.

From the review of the prognosis of variation of main parameters of public scheme for a 70 years period, the prospective period results more problematic than the current period. The public PAYG scheme, for the simulation period, will face the same challenges, problems and difficulties of the current performance. Moreover, in the future, these problems will amplify because of two new factors: population aging and lower possibilities to reduce cost through parametric reforms.

The entire analysis of current and prospective performance demonstrates that Albania, like other countries, is facing the crisis of the public PAYG scheme. The challenges of the public scheme have weakened the financial situation, and have even questioned its continuity. Under these circumstances, finding other ways for reforming the pension scheme and implementing a pension system able to face the challenges of the time is becoming a necessity.

3. PRIVATE SUPPLEMENTARY PENSION SCHEME

The legal framework for the organization of private supplementary pension schemes was set on 01.06.1995. The Law 7923: “Regarding supplementary pensions and private pension institutions” allowed the implementation of the new voluntary column of private supplementary pensions, which would provide supplementary benefits for the elderly compared to those of public mandatory scheme.

Even though the legal framework was implemented in 1995, the first private institution started its activity in 2006, 11 years later. Thus far, there are currently few private schemes and the number of employees registered is very low. Therefore, their position in the life insurance market and pension system is irrelevant. Currently, there are three private
institutions, with a limited number of contributors and with a total fund of contribution of 53.2 million Lek. These schemes are functioning as individual and funded account schemes. They consent the temporary unused fund to be invested. The return of the investment portfolio, along with contributions accumulated in individual account of the employee, belongs entirely to the employee who paid for them. In Albania, the financial market is modestly developed and Tirana Stock Exchange has not yet started functioning. Under these circumstances, the possibility for diversifying the investment portfolio of private schemes is very restricted. The funds of private schemes are invested mainly in treasury bills and bank deposits. But, on the other hand, some of the problems of capital market in Albania are expected to be solved after entering Euro zone and joining the European Union.

The activity of private pension institutions, for years 2007 and 2008, is displayed in table no. 3.

**Table no. 3 The activity of private pension institutions during the years 2007 and 2008**

<table>
<thead>
<tr>
<th>Supplementary pension institutions</th>
<th>Number of Contributors</th>
<th>The total amount of contributions (in thousand Lek)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAPPSH</td>
<td>1,366</td>
<td>1,641</td>
</tr>
<tr>
<td>CAPITAL</td>
<td>631</td>
<td>1,542</td>
</tr>
<tr>
<td>Sigma IPP</td>
<td>875</td>
<td>678</td>
</tr>
<tr>
<td>Total</td>
<td>2,872</td>
<td>3,861</td>
</tr>
</tbody>
</table>

Even though the number of contributors in private pension institutions increased 34.4% in 2008 compared to 2007, it still remains completely irrelevant. It represents only 0.4% of total number of employees or 17.3% of contributors of social insurance supplementary pension scheme.

There are many reasons that affect the unfavorable situation of the insurance market, professional schemes, and individual accounts of private pensions, however, we believe the most important to be the absence of a complete and complex strategy for the reformation of the pension system in order to implement a multicolumn system; the deficiencies of the Albanian financial system, especially of the capital market, in terms of providing a favorable background for facing the challenge of implementing the multicolumn pension scheme reform; the weak integration of Albanian economy in the global economy; the high level of poverty and low level of wages; the lack of tradition and social awareness of the life insurance market; the insufficient attempt of private pension institutions to promote their services; the strong family tradition where children take care of their elder parents; bad experience with the bankruptcy of pyramidal firms; the highly informal labor market; both employers and employees attempt to avoid obligations toward private voluntary schemes and even public mandatory schemes; the absence of law incentives, such as excluding employees’ contributions from income tax and sponsoring employers in private schemes, to motivate savings and employees’ membership in private schemes.

In long the run, along with the reform in the current PAYG scheme, the process of liberalization of the pension system is necessary, in order to avoid the monopoly position of the public scheme in the market. This could be achieved through the introduction of second and third pillars in the pension system and implementation of professional schemes and in-
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individual pension accounts, based on the experience of many other countries that implemented pension reforms. In the meantime, several immediate steps have to be undertaken. These include the development of capital markets and the introduction of incentives that would stimulate the increase of individual savings for retirement. Furthermore, in order to encourage the development of professional pension schemes, a fraction of the contribution that employers pay for the mandatory scheme should be added in the second column of private professional schemes. Finally, another important incentive would be changing tax policy to exempt savings for retirement from being taxed while taxing the benefits or annuities the moment they are collected.

4. CONCLUSIONS

The review of the pension reforms since 1993 demonstrates that the reform process was problematic. The reforms did not achieve neither the transformation of traditional public PAYG scheme, inherited from the previous period, nor the implementation of a developed multicolumn system. Their main purpose was to strengthen the financial stability of the existing scheme and adaption of the scheme with market economy developments.

The analysis shows that during the transition the performance of the public scheme did not change in conformity with the improvements of the macroeconomic situation. The critical level of the dependency rate, which in Albania is not primarily caused by population aging, has weakened the financial balance of the scheme. The situation would be even worse, if the cost increase wasn’t balanced from the implementation of parametric reforms. Those brought some positive effects to the scheme. A very problematic issue is the low level of beneficiaries and the inability of the scheme to provide a relevant increase in the amount of real pension. Voluntary private schemes might operate together with public schemes and might contribute to increase pensioners’ benefits. But, their role is entirely irrelevant.

The analysis of future performance of the scheme for the simulation period shows that the replacement rate and real pension would considerably decrease, while the financial situation of the scheme would slightly improve. This would occur if we assume that the pension would be indexed using inflation rate and that the existing rural scheme would be transformed. This analysis demonstrates that the financial problems of the public scheme are caused not only by transition difficulties, but also by the characteristics of the PAYG scheme.

This complex analysis of current and future situation leads to the conclusion that the current PAYG scheme, even after the reforms, would face serious problems. Some of these problems are:

- The very low level of real benefits from pensions and the financial inability of the scheme to permanently guarantee a constant replacement rate at the base level of 40% (appointed by the International Labor Organization).
- Current social discrimination within the scheme in terms of over-generosity towards special groups of pensioners, like: farmers in the rural scheme; females in terms of pension age; etc.
- Disincentives in the current benefit formula to calculate benefits in relation to the individual savings, which would motivate employees to declare their full wages and raise their insurance period, in order to avoid informality in allocating contributions. Incentives like the application of the very low ratio between minimal and maximal pension (1 to 2) strengthen the allocation capability of the scheme. Additionally,
reallocation capability of the scheme together with the current high level of contributions, weakens the relationship between benefits and contributions and stimulates informality.

In order to eliminate the current problems of the scheme, the occasional implementation on partial reforms must end. These types of reforms might solve some problems, but, on the other hand, they create more. The design and implementation of a comprehensive reform is necessary. This type of reform would conclude the total transformation of the PAYG scheme and, in the mean time, would conceive a liberalized multicolumn pension system. Obviously, the pension scheme reform includes the rural pension system.

The reform of pension system should accomplish two goals: an adjustment of the level of consumption of employees (contributors) during their life cycle, and a reduction of poverty among the elderly. Clearly, these goals cannot be fulfilled using a single instrument, in actuality, different instruments are necessary. The adjustment of consumption rate is increased through the individual account mechanism of each employee. This mechanism ensures the direct relationship between benefits and individual contributions, and it also encourages the increase of financial stability of the scheme. Meanwhile, the reduction of poverty is achieved through the solidarity scheme and benefits’ reallocation.

The study of pension reform starts with the identification of possible options of the reform, which focuses on the future of the PAYG scheme. The different options of public scheme reform might be numerous and should be identified on the basis of comparison and test methods, using the well-known actuarial techniques of different option parameters. But they will always remain within the interval of the two options recommended by the World Bank, which serve as boundaries.

The first option involves restructuring the current contributory system PAYG, strengthening the incentives to ensure that benefits depend only on contributions, and reducing its allocating characteristics. At the same time, the system would be complemented by a non-contributory basic pension and by a social assistance scheme, which would reduce the poverty within the elderly by reallocation of benefits. Additionally, this option would reduce the informality of the scheme, mainly by encouraging employees to pay contributions.

The second option moves in the opposite direction. Recognizing that the current PAYG system needs reformation, it moves further toward redistribution. It abolishes the contributory system, with reduction of poverty as the only purpose. The financing of the scheme will be achieved partially through state budget revenues and partially through contributions. However, these contributions would be small, so that they would not affect the working cost. In order to achieve the goal of adjustment of consumption rate through the life cycle of employees with high and middle income, the second option should include the columns of mandatory and voluntary pensions.

References


1 Dependency rate is calculated by dividing the average number of pensioners (from retirement, invalidity or family) with the total number of contributors on the social insurance scheme.
2 Rate of population coverage is calculated by dividing the number of beneficiaries of the scheme with the total population of the country.
3 Replacement rate is calculated by dividing average retirement pension with net average wage used to calculate the contribution for social insurance.
4 Albania: Projections for Social Insurance Sector for the period 2004-2075
5 Forecast of public pension scheme in Albania and the effects of parametric reforms in its transformation during the period 2004-2050