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PENSION REFORM AND KOSOVO

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Abstract:
This article aims to study the reform of the pension system in Kosovo. In particular, the attention is paid to the new pension system in Kosovo, the reasons for reforming the pension system, the goals as well as the advantages and challenges of the multi-pillar pension model. Always, by trying to make comparisons of the new pension system in Kosovo with the previous one. The study is based on secondary data over the years, provided by different entities. The paperwork is of the theoretical nature of qualitative variables based on secondary data. In general, the findings and analyzes made in this paperwork reflect the period in which many other countries have gone through, including Kosovo. The findings of this study, on one hand, will serve as a summary for state institutions and as a lesson for policy-makers and managers of citizens' money and work, while on the other hand will be information tools for any student or citizen who wants to be informed more about the Kosovo Pension Trust.

JEL: H55, H75, J32

Keywords: pension trust, Kosovo, the reform of pension system, self-sustainability

1. Introduction

The purpose of this paperwork is to outline the reform of the Kosovo pension system. Given that in some respects, Kosovo's experience was unique, while in others the encountered issues are universal not only for Kosovo but for any country that starts a

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comprehensive pension reform. The cessation of pension payments during the conflict in the late 1990s made it easier for Kosovo to abandon the old pension system and launch a new one. However, many aspects of the reform in Kosovo are very important for many countries, especially for small countries with insufficiently developed capital markets. Due to political factors and the pressure coming up from the interested groups, the reform pace was rapid. The regulation on pensions (Regulation 2001/35) was adopted by UNMIK at the end of December 2001, providing the legislative basis for Pillars II and III. All three components of the system became functional during 2002.

2. Study objectives

The purpose of this document is to outline the reform of the Kosovo pension system, while the following objectives:

- How much the rights can be ensured from pension and disability insurance;
- How is the short and long-term life insurance provision of the Kosovo Pension and Disability Insurance Fund;
- How much of the right pension guarantee for all generations in Republic of Kosovo is provided.

2.1 Research questions

1. What was the situation of the Republic of Kosovo regarding the pension management before 1998/99?
2. What are the challenges that Kosovo Pension Fund has been going through?
3. Why is it important to pay attention to Pension Reforms?
4. How effective these reforms have been?

3. Literature review

Social security, as a massive collective security scheme, guaranteed by the state, for the first time began in Germany in the years 1817-1823. Later we find such schemes in Austria in 1888, Luxembourg 1901, Serbia 1910, Russia and Britain 1911, Romania 1912, Poland 1920, Greece 1922, etc. Among many authors who have studied this topic, we have (Balcer-1982, Ferrara-1987, Salisbury-1992, Ascah-1996, Barrientos 1996, Papke-1999, William Lachance, Mitchell, and Smetters-2003, Anderson-2004, G. Gale John B. Shoven, Mark J. Warshawsky-2005, Martin Schludi-2005, Mason, Mills, and Ferrell-2005, Archie and Ferrara-2006, Whiteford and Whitehouse-2006). Also, relying on other authors, we have different opinions from different perspectives regarding pensions by their importance and role, as by employers: "*Although the replacement of schemes with* *defined benefits with contributions plans defined is a cost-saving solution for companies, pension plans are a more effective method for attracting and retaining quality workers rather than wage growth*" (Clark 2000). From the Employee/employer perspective: "*Today, pensions complement a number of functions in the labour market. They serve as an incentive for the loyalty of employers and employees, such as a deferred income tax liability, as liabilities or assets, depending on the needs of the corporate accountant and finally as a pension insurance*" (Bodie, 1990) and also from the Government perspective: "*Minimum vesting rules on pensions should be provided through the federal government*" (Gale, 1994). And from the general point of view: "*Defined contribution plans deal with a number of different obstacles. Currently, the system is built to deal with a short risk list. These are the risk of longevity, or the ability to live longer than property, the risk of replacement, the benefits will not maintain the current standard of living, the risk of social security, potential benefits cuts and investment risk, poor performance of investment*", (Gustman, Mitchell and Steinmeier, 1994).

Apart from foreign authors, there are local authors who have researched on this topic, such as: Lena Zezulin-2007, Merita (Vaso) Xhumari-2009/10, Yllka Bina- 2013, Nexhmedin Shaqiri- 2016.

4. Methodology of the paperwork

This research has an evaluation nature as well as explanatory. Evaluation research because it assesses the impact of Pension Reforms on the domestic economy and on the other hand explains what was the best policy with regard to Pension Reforms in Kosovo. The theory used in this research is meso-macro theory. In this research, we used secondary data to make this paperwork more valuable. We referred also on the publications of annual reports of the Public Institutions (Ministry of Welfare and Social Work, Statistical Office, Trust and Ministry of Economic Development).

4.1 Reforms and structure of the Pension System in Kosovo

As far as the Pension System in Kosovo is concerned, it he started to be organized from 1945 onwards, funded by state's financial resources and was supplemented by pension contributions paid by personal income earners (PIEs). Between 1966 and 1974, the Kosovo Pension System was an integral part of the Pension System of the Republic of Yugoslavia (PSRY). This system was based on the PAYG (Pay-As-You-Go) principle. The Yugoslav pension system in 1987 reached a higher number of pensioners than the number of contributors, so the amount of pension benefits was four times higher than the amount of pension fund income through pension contributions. So this system began to operate with a financial deficit, which was covered by the state budget, but then began to emerge as one of the causes of the economic crisis in Yugoslavia. Between

1998 and 2002, elderly Kosovars did not receive pensions and various employees did not contribute to any pension system because the functioning of the Yugoslav pension system was blocked by Serbia. It also interrupted the possibility of retirement for older workers, so there was a need to establish a new pension system in Kosovo.

Table 1: Pensioners receiving pensions as of December 1998

Birth Year	Old-age	Disability	Survivor	Total
< 1902	2	5	10	17
1902-1930	11,669	7,789	12,959	32,417
1931-1935	9,786	5,352	4,708	19,846
1936-1940	8,569	5,110	3,610	17,289
1941-1945	2,235	3,658	2,304	8,197
> 1945	784	4,958	3,999	9,741
Total	33,045	26,872	27,590	87,507
Aprox. Total <1937	25,742	15,701	19,482	60,925
Adjusted Total <1937	21,202	12,755	14,954	48,911

Source: Kosovo Social Insurance Fund

Table 1: Shows the number of Kosovar pensioners from 1902 to 1945. The table shows that there is a small number of pensioners from Kosovo who received this pension under the leadership of the Yugoslav pension system. Only one-third of Kosovo's population received this pension. While our leaders and policy makers, by witnessing the situation of the Kosovo pension system in 2001, concluded that it's necessary and reasonable to reform the pension system through UNMIK, as an interim administration of Kosovo, in order to achieve its sustainability. In 2001, relevant UNMIK authorities issued the Regulation on Pensions (Regulation 2001/35), and the proposal for a new model of the pension system, i.e. a disconnection from the former Yugoslav pension system. The new pension system started to be implemented in 2002 and aimed at covering all the residents of Kosovo.

4.2 Pension System Reform

The system is designed based on the division of functions, Pillar I ensures the avoidance of poverty, Pillars II and III serve as an instrument for additional savings. So in practice, the drafted pension system in Kosovo does not fully address the abovementioned functions through three different financial and managerial arrangements.

A. Pillar I

In the first pillar, there are all individuals who are 65 years of age, of both genders, and it's legally stipulated, which means on the right to a pension in Kosovo including for all those who are considered as incapable of work, this pension is provided by

Government's incomes (State Budget). This scheme is considered as a pension fund and a tool for mitigating poverty. But having more and more individuals benefiting from the first pillar, this leads to increased burden on the state budget and jeopardizes the overall sustainability of the system. By 2009, there was a same category (flat rate) of pension value for all pensioners. Then a Government decision introduced a categorization as an addition of 35 euros to all persons who contributed at least 15 years before 1999. This legislation brought discrimination between contributors who had not reached 15 working years experience and for all the others who have contributed for more than 15 years. Now the basic pension is 80 euros and is regulated by Regulation 2002/15. Under this regulation, the pensions should be determined annually by the Ministry of Finance (MoF). The table below shows the basic pension scheme from 2004 to 2015.

Table 2: Basic Pension Scheme

Years	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Females	49,125	67,038	68,035	70,287	73,853	59,970
Men	49,872	57,857	59,321	61,588	64,994	52,583
Total number	108,279	124,893	127,356	131,875	138,847	112,553
Annual Expenditures	**54,912,559**	**59,313,333**	**61,984,790**	**63,477,840**	**66,196,720**	**67,075,225**
Years	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Females	71,516	69,998	73,865	82,044	76,417	46,053
Men	38,342	37,147	39,178	43,839	40,625	85,947
Total number	109,858	107,145	113,043	125,883	117,042	132,000
Annual Expenditures	**94,540,635**	**61,183,400**	**69,204,080**	**87,340,090**	**108,312,220**	**120,456,558**

Source: Ministry of Labor and Social Welfare

The table above shows that the annual expenditures for the category of pensioners are increasing each year due to the increase in the rate of new pensioners. And we also notice that female gender has higher participation in pension benefits than male. This scheme is very costly for Kosovo's budget; it is a downstream scheme and is also called a social pension. Today there are around 100 states that offer this social pension. The other main reason for the basic pension is that due to the lack of respect for the law as well as many legal uncertainties, they have left room for misuse of basic pensions because the basic pension is paid to any elderly who has reached the third age in the Rep. of Kosovo even if they don't live in Kosovo, without respecting the criteria for being a permanent resident of the Republic (Article 7, No. 04 / L-131). While according to the Law, the individual with disabilities has the right to obtain pension until 65 years of age, and then the disability pension is replaced with the basic one. In 2009, a new rate was announced, so the pension benefit rose slightly from €40 to €45. This scheme covered 19,056 individuals in 2015, compared to a budget expenditure of €17,066,255 (see Table 3).

Table 3: Disability Pension Scheme

Years	Number of beneficiaries	Monthly rate	Annual Expenditures
2002	-	-	-
2003	-	-	-
2004	15,077	40 €	7,248,160
2005	21,786	40 €	15,480,160
2006	19,981	40 €	14,795,396
2007	19,203	40 €	10,089,562
2008	20,053	40 €	10,022,300
2009	17,264	45 €	11,460,218
2010	19,392	45 €	11,446,870
2011	18,594	45 €	11,151,240
2012	17,531	45 €	11,558.210
2013	12,240	45 €	14,272,440
2014	18,318	45 €	15,367,470
2015	19,056	45 €	17,066,255

Source: Ministry of Labor and Social Welfare

From the disability pension scheme financed by the budget of Rep. of Kosovo we notice that the annual expenditures are constantly increasing also for this category.

Table 4: Pensions Payment (in 1989 and 1998) and Contributed Pension - Pillar I

Years	Monthly pension	Average personal income	%
1989	137.50€	202.70€	67.83%
1998	69.00€	102.90€	67.08%
2003	35.00€	200.00€	17.50%
2012	80.00€	374.00€	21.30%

Source: Pensioners Association of Kosovo, BVI PIK - FIP 1989-1993, Riinvest 2003, SOK

Table 5: Contribution-based scheme

Years	Number of beneficiaries	Monthly rate	Annual budget spent
2008	27,774	35€	11,286,910.00
2009	22,883	35€	12,104,470.00
2010	30,641	80€(45€+35€)	30,899,760.00
2011	32,415	80€(45€+35€)	31,670,450.00

Source: Ministry of Labor and Social Welfare

B. Second pillar

Pillar II of the system is a compulsory pension program with a definite contribution of savings. The program requires that all permanent residents of Kosovo contribute with 5% of the gross wage in the pension trust. This employee's contribution is compared with an additional 5% contribution from the employer. Both workers and employers have the right to voluntarily contribute an additional 10% of gross salary. In August 2002, this scheme was initially presented to public sector workers and public enterprises, while in August 2003 included private individuals employed as well as self-employed persons. Contributions and records are managed by the Kosovo Pension Savings Trust, an independent body created solely for the purpose of managing the savings pension system. The Trust has staff from Kosovo and employs a Steering Board with a combination of domestic and foreign members. For details, we have the following table which provides data over the years.

Table 6: The number of pension beneficiaries and the number of employed people (2002-2015)

Years	The number of employees	The number of those who exploit pensions	The number of employees to 1 pensioner
2002	373,000	93,086	4.0
2003	524,200	108,279	4.8
2004	637,000	116,932	5.4
2005	586,300	124,893	4.7
2006	734,800	127,356	5.8
2007	599,300	131,874	4.5
2008	584,500	138,847	4.2
2009	723,200	130,347	5.5
2010	678,700	109,585	6.2
2011	748,400	107,145	7.0
2012	769,200	113,043	6.8
2013	472,900	117,042	4.0
2014	466,700	125,883	3.7
2015	617,400	132,000	4.7

Source: http://ask.rks-gov.net

Table 6 shows the number of employees and the number of pensioners from 2002 to 2015 in Kosovo. Above all, we notice that from year to year we have an increase in the number, except in 2013 and 2014 in which a downturn is recorded. In terms of contributors and beneficiaries report, we still notice that the ratio is quite high. The highest rate was reached in 2011. This is also an indicator that shows that the population is moving towards the third age, and the ratio between the variables has increased.

C. Third pillar

This system pillar provides additional, individual support for private pensions. The schemes are licensed and regulated by the Central Bank of the Republic of Kosovo (CBK), there is currently a private fund called Slovenian-Kosovo Fund (FONDI). In addition, following the example of other post-socialist transition economies, it would have to be expected that voluntary individual arrangements, perhaps through insurance companies, would be provided and regulated in order to prevent consumer's fraud and to encourage the growth of financial sector (See table no 7).

Table 7: Third pillar

Description	June 2012	June 2013	June 2014	June 2015	June 2016
Kosovo	99.30%	99.40%	99.40%	99.50%	99.50%
Slovenia-Kosovo	0.70%	0.60%	0.60%	0.50%	0.50%

Source: CBK

Also, a large part of the literature on economic argues that financial markets (indeed all markets) operate more efficiently without regulatory intervention. The Kosovo Pension Savings Trust (KPST) represents the largest part of the sector's assets (99.5%), while the remaining part is managed by the Slovenian-Kosovo Pension Fund (FSKP). In the table below, we have summarized three (3) reforming steps of the Pension System in different aspects. Here you can see exactly the differences between these three pillars.

Table 8: Summary of three pillars of the Pension Scheme

	First degree Basic Pension	Second Degree The obligatory pension	Third Degree Volunteer Pensions
Admissibility	All citizens	Contributors	Contributors
Contribution rate	/	5% Employees 5% Employment	It varies in different periods
Methods of Assurance of Assets	PAYG	Wage Contributors, Financiers	Funded by the employer or individual contribution
Participants	All residents	Employee	Volunteers
Beneficiaries	All permanent residents, or 65 years and over 100% disabled	Defined Contributors	Defined Contribution or Defined Benefits
The insured	The entire third age, who is over 65 years of age	All individuals working in the Republic of Kosovo	Very limited
Fund Collectors	Kosovo Pension Administration	Trust	Employers, pension funds, insurance companies, banks
Regulatory and Supervisory Bodies	Ministry of Labor and Social Welfare, Ministry of Economy and Finance	Banking Authority of Kosovo Payments	Banking Authority of Kosovo Payments
Investing	No Investment	Banking Authority of Kosovo Payments	Licensed asset managers and insurance companies, Banks
Asset collection agents	No Investment	Professional asset managers	Licensed asset managers and insurance companies

Source: http://siteresources.worldbank.org

4.3 The reasons for the Pension System Reform

Based on what we explained so far, we can understand the reasons that influenced the reform of the Kosovo pension system, which may differ depending on the perspective that can be looked at. For this reason, we have listed five main reasons, as below:

- **First reason** of the Pension System Reform was political context;
- **Second reason** was the purpose to design a new system of pension reform in Kosovo, in line with the most advanced practices in different countries of the world;
- **Third reason** was to leave the system based on the principle PAYG (Pay-As-You-Go);

- **Fourth reason** is the standardization of Kosovo Pension System with the ones of European Union countries, as well as participation in developed financial capital markets;
- **Fifth reason** is the research for further improvement of the Pension System.

4.4 Employer – Employees Reports

There are many cases in Kosovo that private companies operate in the market but do not declare workers' contributions and which greatly damage Kosovo's budget. In the absence of inspections, this phenomenon is supposed to be higher than the one declared in the World Bank study in 2003. More than half of the employed people in Kosovo work without a job contract or work in unregistered enterprises. The problem of informal economy is also highlighted in an OPS survey, according to which 50% of young people work in the informal economy, and 73% of whom do not pay social security contributions. Realistically, foreign companies and a small number of successful local companies often decide to pay contributions in accordance with the law. According to some EU reports, the results show that employers are the main actors responsible for luck of contributions payment to Kosovo. On the other hand, even if they are willing to pay, private sector employees do not have the power to encourage their employer pay contributions because they may be exposed to losing the job. Given the large-scale unemployment and difficulties in finding a job, the ability to report such cases to the authorities seems almost impossible. Thus, the majority are reluctant to undertake such actions. One of the important factors is the lack of information and awareness on the benefits from pension systems. This is mainly due to the negligence of the responsible authorities. Other reasons that may further increase the non-payment of contributions are the lack of confidence in the state and in the system.

5. Conclusions and Recommendations

From the current policies, we have noticed that coordinated attention to pensions, taxes and other socio programs is needed to significantly reduce the overall burden of labour. In Kosovo, labour taxes have been kept low by financing Pillar I from general incomes and not from a payroll tax, by not creating any other tax on social payrolls and keeping at a low level the personal income taxes. However, shifting to any of these three areas would undermine the efficiency of the labor market;

Kosovo's experience shows that a capital-free country still cannot establish a stable financial pension system because investing in pension assets abroad and also using foreign professional expertise in making investment decisions has greatly influenced domestic market investment;

Administrative expenditures can be important and should be taken into account at the design stage of the reform. Funded pillars should be designed in a way that they are large enough to reach the level of the economy, with administration and cost-effective;

Those who are able to save should be encouraged to do so and contribute through affordable and secure pensions of the third pillar in exchange for less taxes and other incentives.

In general, there is a very low level of information and public awareness among all private sector institutions. KPST, TAK and other relevant ministries (as well as other governmental bodies) should prepare, organize and implement public awareness and public information campaigns.

Realistically it would be a good idea that the first basic pension scheme to be partial, where one part should be fixed for the entire third age and that will guarantee a minimum pension and a variable part based on work experience or level of education by including the entire third-generation population of the Republic Of Kosovo, and in order not to charge the state budget it would be good that proportions of some revenue expenditures are allocated for basic pension funding.

As regards the second scheme, it would be good the rate of contributions from the employee and the employer not to be proportional. This also motivates workers at work and on the other hand, it secures a higher accumulated fund when they are at the third age.

Also from voluntary contributions in Kosovo, there is a low turnout of investments, which would be good to encourage both local people and our relatives from diaspora to invest in this fund. From the accumulated money, the state will have to follow policies that will promise them higher return on investment.

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