SELECTED ASPECTS OF THE SOCIAL SITUATION AND DEVELOPMENT OF THE PENSION SYSTEM IN KOSOVO

RESEARCH REPORT
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SUMMARY

1. In the present social situation in Kosovo, one of the most urgent social and economic issues is the need to develop a Pension[1] System.
2. The United Nations Interim Administration Mission in Kosovo (UNMIK), the Central Fiscal Authority of Kosovo (CFA), and other international agencies such as the World Bank, the United States Agency for International Development (USAID), and the International Labour Organisation (ILO) have been actively engaged in developing a pension system in Kosovo. As a result, a draft of “Pensions Regulation” (hereafter “Draft Regulation”) has been designed and is currently pending approval.
3. Analysis of the “Draft Regulation,” as well as analysis of the experience of various developed countries and countries in transition, reveals that the proposed pension system incorporates the lessons and experiences of most advanced systems and adopts them to the specific context of Kosovo.
4. The “Draft Regulation” covers the entire population of Kosovo over 65 years of age and provides for a basic pension that would help the elderly to afford basic consumption, and to contribute to their family incomes. It also introduces a modern system based on investing workers’ and employers’ pension contributions into financial instruments.
5. The “Draft Regulation” establishes legal basis for voluntary contributions and provides a regulatory framework for supplementary voluntary pension plans, which would encourage increase in savings among Kosovars. The accumulation of pension assets along with potential for their future investment in the domestic capital market is of a high value for Kosovars. It represents an important factor that will promote creation and development of a capital market in Kosovo and will contribute to the Kosovo’s economic development.
6. The proposed average contribution rates are low, as compared to those of the systems in many other countries. We believe that such rates will be well accepted by the workers and by the employers. The level of contributions to the funded pillar in

Kosovo is comparable with the social security contribution rates in industrial countries like Switzerland (9.8 %), Canada (6%), and the United States (12 %). At the same time, the proposed level is two to three times lower than the contribution rates in the countries in transition, like Albania (36 %), Bulgaria (32 %), and Slovenia (24 %). It is very important to inform and educate the Kosovar public about all the solutions the proposed "Draft Regulation" offers, in order to generate support and involvement in advocating its prompt implementation.

7. Substantial resources will have to be committed and administrative capacity will have to be developed to effectively manage payments of the basic pensions: new staff will have to be hired and trained, facilities will have to be renovated, and arrangements will have to be made for establishing a pension benefit delivery system.

8. Structure of the funded pillar proposed in the regulation will help to mitigate administrative costs in the new system. Policies will have to be developed that would seek to limit increase in these costs and at the same time ensure adequate services.

9. Throughout the process of building a pension system in Kosovo it will be necessary to address several specific issues; some of them will require immediate policy attention, while others should become part of the long-term reform strategy. Currently there is a wide spectrum of open issues, not all of which could be included in the "Draft Regulation" and they will have to be addressed later. We believe that the following issues should be considered while developing a broader long-term strategy for social sector reform:

   a) A critical issue is that of the social status of workers dismissed immediately after Serbia's repressive actions in Kosovo (1990). These workers, who are not aged enough to qualify for the old-age pension, are nevertheless too old to find work easily.

   b) The social situation of current pensioners will be difficult to resolve with pensions lower than 55 Deutsche marks, the level suggested by the World Bank as being the cost of the minimum consumption basket. In addition, a strategy must be developed that addresses the health care financing needs of pensioners.

c) One of the most acute issues is that of disabled pensioners and war veterans. Regulation has to be developed, criteria should be set, and capacity should be developed for effective assessment of eligibility for disability benefits.

d) Any proposal related to development of the safety net in Kosovo should be evaluated in the perspective of its potential macroeconomic and budgetary implications. Analysis of the domestic labor market made by Riinvest leads to conclude that financing extensive social programs through payroll contributions may be difficult due to the low level of formal sector employment. During the periods of economic and social distress, the policymaking process must strive for maintaining delicate balance between the social assistance needs and the development priorities.

e) All Kosovars after they reach the age of 65 will have the right to a flat basic pension. Although this appears to be equitable and fair, this puts the elderly in materially unequal positions since some pensioners also receive pensions from other sources such as Serbia, Switzerland, and so on. This issue needs to be further addressed in developing the pension system.

f) The ability to realistically provide for pension payments will depend on the Kosovo's budget, that in the short term will be adversely affected by the decreased level of foreign aid. Possible solution that would particularly address the situation of old-age and disabled pensioners, as well as dismissed workers who do not yet qualify for a pension, may be to use some funds generated by the privatization of socially owned and public enterprises. Political consideration will also have to be given to the potential use of proceeds from privatization as compensation for the pensioners who contributed to the old system. Hence, we would advocate taking active steps for initiation of the privatization process.

POLICY RECOMMENDATIONS

- Rapid approval of the proposed pension system, and its implementation in year 2002, is recommended.
- Improvement in the existing pensioners' social and financial status should be given further consideration when designing a long-term strategy for Kosovo's social development. The question of disabled war veterans and disabled workers needs to be settled as soon as possible. In the meantime, it is necessary to reexamine the social and administrative criteria for establishing disability benefits scheme.
- The methodology that will be developed and approved by the Assembly in 2002 should ensure that the level of basic pension benefits is set at least at the level of the minimum consumption basket, which would imply monthly benefit of approximately DM 55. Such benefit would have to be adjusted for subsequent years according to growth in the cost of that basket.
- Political consideration should be given to using some share of the proceeds from privatization as compensation to those who contributed to the old pension system, as it has occurred in several other countries.
- An all-encompassing program of technical assistance for building managerial and administrative capacities for administration of both the first and the second pillars of the system will have to be developed and implemented.
- A program of informing and educating the public on the solutions offered by the new pension scheme in the overall economic and social context of Kosovo must be implemented.

1. INTRODUCTION

Preparation of this report and its presentation at the International Round Table Forum in Pristina on December 12, 2001 is a part of the two-year project entitled “Promotion of Economic Development Through Civil Society,” which the Riinvest Institute has been managed in co-partnership with the Center for International Private Enterprises (CIPE) in Washington D.C., supported by the USAID Mission in Pristina. The project’s goals are:

1. Improving economic policies and the business environment in Kosovo through increased local participation;
2. Collecting and analysis information on effective economic development policies;
3. Initiating debate on those policies; and
4. I involving the business community and civil society in a dialogue on economic reforms and aspects of creation of an open market economy.

During the first year of the project’s implementation, three modules have been developed and discussed at the International Roundtable Forum, namely, privatization, certain issues of building and implementing fiscal policy, and financing and development of Small and Medium Enterprises (SMEs). Riinvest has presented recommendations on the these issues that reflect the research results and the views of the professional and business community in Kosovo.

This is the fourth research report in the series of the RIINVEST research reports. The report reviews general social situation, with an emphasis on the current status of pensioners, and also on the need for building a contemporary pension system in harmony with the current development processes, while shaping the system on the principles of the market economy and Kosovo-specific aspects.

1.1. Purpose of Research Report

The purpose of this report is to present a set of recommendations and to advocate for the establishing pension system in Kosovo as an important element of social insurance that represents important subsystem of Kosovo's budget and is closely related to the development of modern domestic financial institutions.

The report will present the current social situation in Kosovo as it relates to the pensioners' position. Beginning with recent problems in the functioning of a pension system in Kosovo, and based on experience of other countries in building and reforming pension system, the report addresses the following specific issues:

- ➔ Current problems of pensioners and the building of a pension system in Kosovo:
  - ° The social situation, particularly as it affects the current position of pensioners;
  - ° The urgent need for building a new pension system;
  - ° Current efforts in building a pension system;
  - ° Suggested solutions in developing a new pension system;
  - ° Experience of pension system of European Union (EU) countries, Organisation of Economic Co-operation and Development (OECD) countries, and countries in transition;
- ➔ Issues in developing new pension system:
  - ° Pensioners' current economic condition;
  - ° Issues specific to disabled pensioners;
  - ° Pension management and administration.
- ➔ Analysis of pension system within the context of economic reforms and economic development:
  - ° Pension in relation to increase in Gross Domestic Product (GDP);
  - ° Relation among pensions, employment, earnings, and budget;
  - ° Investment of both mandatory and voluntary pension contributions and development of the financial institutions.

1.2. Methodology

In addition to analysis and data produced by Riinvest in collaboration with other institutions, this report draws on results of Riinvest's projects in the past, including:

- Economic Activities and Democratic Development of Kosovo

- Building and Functioning of Local Governmental Institutions in Kosovo
- Kosovo's Postwar Reconstruction—Strategy and Policies
- Survey of 300 Private Businesses in 1997, 1999, and 2000
- Survey of 194 Socially Owned Enterprises in 2000
- Survey of 3,500 Families and Family Economies.

In preparing this report, materials from the following sources have been used:

- The World Bank Group
- International Labor Organisation
- CFA and other UNMIK bodies
- Institute of Statistics
- Experiences of Albania, Croatia, Hungary, Kazakhstan, Poland, Slovenia, and several OECD and developing countries.

In preparing this study the following activities took place:

- For setting framework for the study, several meetings were held with pension and fiscal experts at the CFA and USAID.
- Five interviews were conducted with pensioners from different social background.

As a special research activity, Riinvest carried out a survey of 110 randomly selected former pensioners. The pensioners were selected from seven main regions of Kosovo, with an average of 15 pensioners from each region (five pensioners from villages and ten from towns). The sample also included pensioners from the following four pension categories:

1. Old-age pensions
2. Special occupations pensions
3. Work disability pensions
4. Survivors pensions

- With regard to the use of experience of countries in transition, Riinvest made a research trip to Albania and Slovenia to study experience in the field of social and pension policies. Riinvest also received contributions from three experts from Macedonia, Poland, and Slovenia that are included in the annexes to this report.
- In compiling this report we consulted with independent experts, both local and international.
- Finally, the Riinvest Business Advisory Board and several businesspersons were invited to provide their expert opinions on this report.

2. Some Aspects of the Social Situation in Kosovo

The problems of economic development of Kosovo in the past and discriminatory policies carried out by the Serb regime have direct implications for the current social problems. The war in Kosovo displaced about 90 percent of the population; of that number, about 64 percent were forcibly deported from Kosovo. Direct damages inflicted to the private sector—theft of cash; burning or destruction of 40 percent of the houses; loss of household utilities; losses of crops, agriculture equipment, and livestock; damages to private businesses, and so on—resulted in a reduction of family budget income by over 70 percent during the war. After the war, because of prevailing conditions, 8 percent of displaced or deported families did not return to their previous settlements (see box 1).

Box 1 POVERTY ASSESSMENT STUDIES IN KOSOVO

To date, two important studies on poverty have been conducted in Kosovo. These studies approach poverty from various angles. "Living Standard Measurement Survey " (LSMS) measures poverty based on consumption, while a CARE study has a multidimensional approach, specifically the concept of security of family assets. The first defines the extreme poverty of life "under the line of food poverty" in a family with insufficient resources for ensuring a basic food basket of 2100 calories a day for adults. In Kosovo this would correspond to a daily consumption of US$0.80 (DM 1.8539) for adults. A "full line of poverty" has been defined as a wider consumption, including non-food items, valued at US$1.50 (3.499 DM) for adults.

The CARE study focuses on poverty as it related to scarcity of physical and material goods, as well as how it relates to a broader set of non-material, social, and human welfare indices. Analysis shows that the key cause of poverty in Kosovo is the decline of economic activity in the 1990s. Consequently, it is exacerbated by the reduction in job creation associated with war related conditions.

Source: World Bank, "Kosovo: Poverty Assessment. " October 3, 2001. ILO, " Strategy for Social Insurance in Kosovo. " September 25, 2001.

Half of Kosovo's population is at or below the poverty level, while 12 percent of the poor live in the conditions of extreme poverty[2]. That is, 1 to 1.2 million inhabitants of Kosovo live in poverty or extreme poverty[3]. These Kosovars are poorly fed, poorly dressed, live in an environment of poor public health and services, and have little or no access to education.

Among the very extreme social problems that must be addressed and resolved as soon as possible are the following:

- Former pensioners who have not received pensions since 1999.
- War veterans who are of working age, but unable to work.
- Disabled individuals who are below 65 years of age, and do not qualify for a basic pension.
- Orphaned children.
- Population living in extreme poverty.
- Families without a head-of-family, particularly the widows who have no educational or professional training, and are therefore not qualified for formal employment.
- Rural population that has temporarily migrated to towns, and are without sources of livelihood, except for the assistance given by humanitarian organizations.

2.1. Social Welfare

As a consequence of war, many families were left with no family head, over 1,200 children were orphaned, and the material situation of disabled and war veterans deteriorated. Former employees of socially owned enterprises who lost their jobs and are left without a regular source of income are also strained economically.

The social welfare assistance in 2001 alone covered over 53,916 families with an aggregate of 186,308 members[4]**.** The monthly benefit level of social assistance ranges between DM 60 and DM 120 per family. While in the year 1990, 1.7 percent of the population used social assistance, in the year 2001, 9.3 percent of the population already depended on social assistance. However, not all the population living in conditions of extreme poverty is covered by the social assistance network.

2.2. Family Income

The deterioration of the social situation in Kosovo can be seen in the reduction of average family income by 50 percent and decline to about 300 DM a month on average. At present, there is no pension system in place to compensate the pensioners for such a dramatic decline in their family and personal income.

While on the one hand, the number of families with wage earners, families with income from businesses, the families with other sources of income has decreased dramatically, compared to the pre-war period, on the other hand, the number of families living on humanitarian relief has increased 10 times. The number of those living on funds received from abroad has also increased several times. Remittances received from abroad represented half of the budgets of Kosovar families in the immediate post-war period. Following the war, a number of families had to liquidate their savings and often resorted to selling their real estate to ensure a minimum level of survival. Approximately 60 percent of the family budget had to be spent on food alone.

2.3. Poverty in rural and urban areas

Rural families with very low income constitute a major portion of the population living in extreme poverty. Some of the rural families whose economic basis and life sustenance resources were destroyed during the war have found shelter in towns. These families, which represent a particular segment of the society are unprepared for urban living, lack education and have no professional qualification for urban work.

The population in urban areas- only 40 percent of overall population - includes a major part of the poor population, including those in extreme poverty. While in rural areas basic livelihood may be scratched from a small piece of land, for urban families the unemployment means the complete lack of a livelihood. About 12 percent of the rural population migrated to urban areas after the war had destroyed their economic foundation; humanitarian relief organizations provided shelter for these ‘economic refugees’ there. Because of this internal migration, the proportion of population categorized as “extremely poor” increased in the urban areas.

2.4. Unemployment and Employment

The high level of unemployment—as a result of development problems, the war, and problems in managing the emergency phase of reconstruction—is a critical social and economic problem in Kosovo. Ten percent or more of Kosovar families are without an employed family member. Unemployment that is currentrly estimated to be in the range of 45 to 55 percent is down from the period immediately after the war, when it was at 74 percent.

Table 1 Structure of the Labor Force in Kosovo, 2001

Forms of employment	**Number of employees** (thousands of workers)	**Structure** (percent)
Private enterprises	135	30%
Other businesses	50	11%
Social enterprises	50	11%
Public Services	75	17%
Farmers	90	20%
Small unregistered businesses	50	11%
Total employed in Kosovo	450	100.0%
Employed abroad	100–150	

Source: SME survey, SOE survey, Riinvest estimates.

Reliable statistical information on employment is limited and therefore assessments of the levels of employment and unemployment may vary between different sources, although they all reveal the overall similar situation. In the absence of a legal framework governing employment contracts most new jobs have been created outside the scope of formal employment institutions, as a result there are no reliable statistics on the number of total employment. Even with rough estimates, however, it is clear that the level of employment is extremely low, which poses a major challenge to macroeconomic and social development of Kosovo. The creation of an environment that promotes job generation should become a top policy priority. Correspondingly, a set of development policies should be designed that target investment in infrastructure and human capital and that maintain international cost-competitiveness of the

Kosovo labor force. Any proposals related to social sector development that assume payroll-tax financing of social programs should be viewed for its potential implications for the domestic labor market.

3. Problems of Pensions and Building of Pension System

The pension system is a kind of social insurance that ensures financial support for those who are unable to work, including the elderly. From the perspective of the individual, a pension system provides a major mechanism for lifetime consumption smoothing. For most of the elderly population, pension benefits present a main source of income during retirement. Hence, every country has developed its own strategy to offer social security to its people; this expresses society's solidarity with groups who are at risk because of health problems, old age, and unemployment. Thus, with social security and through a redistribution of income, social welfare is ensured.

Currently Kosovo does not have a functional pension system. According to 1998 data, as many as 89,135 persons who once received pension are currently receiving no pension at all.[5] (This number does not include Serb pensioners, who continue to receive their pensions from Belgrade, and other pensioners who receive pensions from abroad.) This situation has created considerable social inequality; former pensioners are persistent in their demand for solution to this critical problem.

The elderly pensioners are concerned with the fact that they have been contributing to the old pension system but currently are not receiving any form of compensation. Through repressive measures in Kosovo after 1991, the Former Republic of Yugoslavia dismissed around 128,000 ethnic Albanian workers thereby depriving them of the opportunity of making pension contributions. Therefore, many believe that the obligations of Belgrade, apart from compensating for past contributions include the compensation for the repressive measures and the exodus of workers and their families. There is a considerable common understanding that this important political issue should be put on the future policy agenda.

Following the conflict in Kosovo**,** UNMIK began a program of general social assistance to families with insufficient incomes, which included some categories of elderly. This support does not cover the largest part of the aged population, and does not include those who paid contributions into the old system. The system of social assistance is only implemented for the poorest families, based on their social budget.

There is an urgent need for developing a new pension system. In Kosovo, a new system of pensions as has to be built as an indivisible part of building a new economic system. The new system should be based on the principles of fairness and equity, it must be financially sustainable, and it must, in the best possible way, address the complex set of interests of various groups of the Kosovar population.

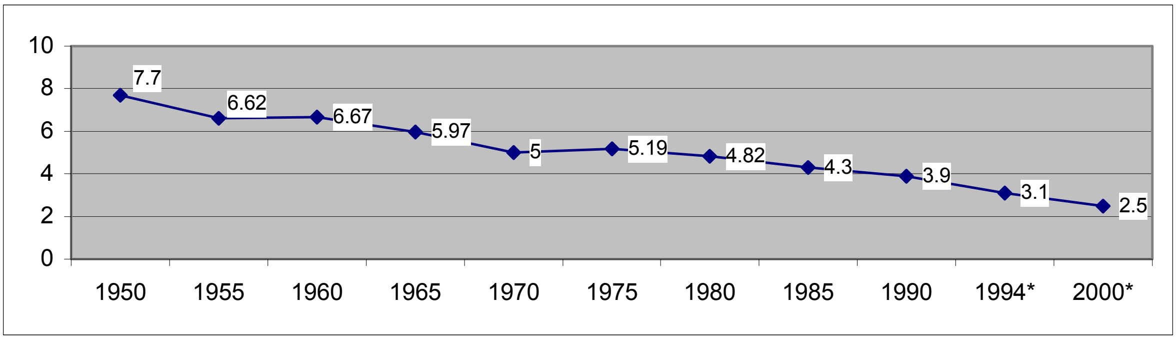
3.1. Demographic Development in Kosovo

There are various estimates of the current population of Kosovo. Research by the Riinvest Institute assessed that in 1997 Kosovo had a population of 2.3 million, including Kosovars working temporarily abroad; it is estimated that in 2001 the population is over 2.4 million. [6] Estimates made by international institutions put Kosovo's population at around 2.2 million. Out of this number over 5.7 percent, or around 130,000 individuals, are of age 65 or more. There are around 1.4 million people of working age (16–64 years).

The fact that Kosovo's population is experiencing the start of an aging trend is supported, in particular, by the fertility data. While in 1950, the fertility rate was 214.4 children per 1,000 women, in 1985 the fertility rate for the same number of women declined to 133.2 children.

Figure 1 Fertility Rates in Kosovo

Number of live births that average women gives during her life



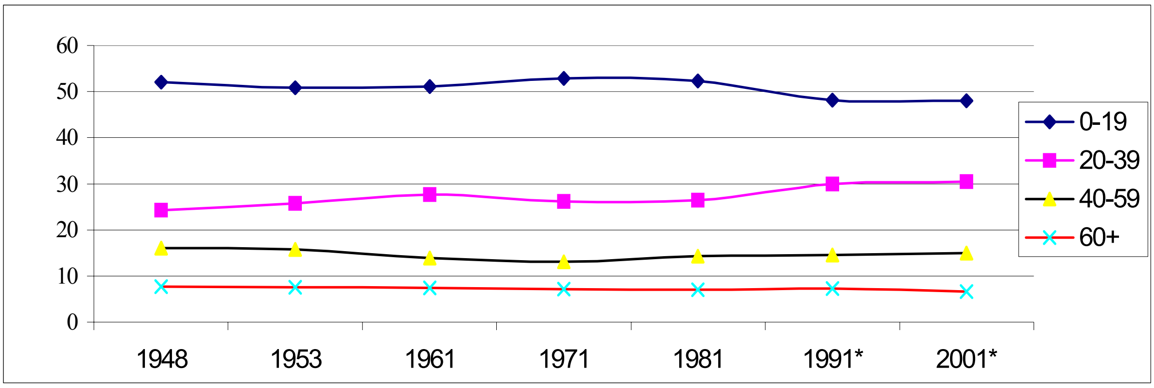
* Riinvest Institute assessments.

Source: Documentation of Secretariat for International Development, Planning and Scientific and Technical Cooperation of Kosovo 1989.

One of the important factors that has contributed to the fertility reduction in recent years is the heavy emigration of Kosovars to other countries during the period from 1990 to 1999; this emigration has resulted in delayed marriages, and a consequent decline in births.

Demographic dependency ratio in Kosovo (defined as the ratio of the elderly to those who are employed) between the elderly and those at the working age is comparable to other countries (see figure 2). There are 11 working age persons in Kosovo for each person over 65 years of age. However, considering all those employed domestically, the effective dependency ratio is much higher at 1 : 3.5, and it is only 1 : 2.5, if we limit ourselves to considering only those in the formal economy.

Figure 2 Structure of overall population in Kosovo



* Riinvest Institute assessments.

Source: Kosovo Demographic data.

From figure 2, we can see that the share of the young population in the overall population has begun to fall in recent years. Riinvest's estimate is that, since 1981, because of the effect of emigration of young people and their families from Kosovo, the share of the 19-year-old age group in the population structure has fallen from 52.3 percent (in 1981) to 48 percent (in 2001). At the same time we observe a slight fall in the age groups of those over 60-years-old prior to 1991, and a slight increase of this age group in the following years, which is an expected trend. An increase of those over 65 years of age is expected, with an annual rate between 2 percent and 5 percent. Such trends of relative increase of aged population underline the need for building a consistent pension system that, within the conditions of a market economy, would be able to provide sustainable support to the retirees. The percentage share of the age group over 65-years-old in the population is expected to double over the next five decades (see table 2).

Table 2 Dynamics of the number of pensioners

Year	2001	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050
Over 65 years of age	131,548	146,436	174,732	209,529	249,456	297,499	334,890	374,888	427,772	500,032	586,085
Share in total population	5.8%	6.0%	6.6%	7.4%	8.2%	9.1%	9.6%	10.0%	10.7%	11.9%	13.2%

Source: UNMIK estimates.

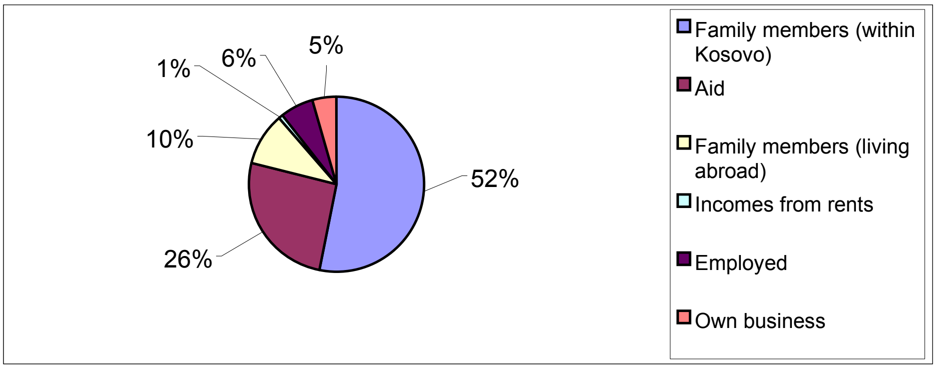
However, contrary to the situation in many countries where an aging population exerts pressure on the pension funds, in Kosovo the share of persons 65-years-old would continue to remain relatively low. This is a positive aspect for financing pensions.

3.2. Social Situation and the Position of Current Pensioners

In October 2001, Riinvest Institute surveyed 110 individuals of seven regions of Kosovo who used to receive pensions under the old system. The random sample included elderly pensioners, pensioners of special occupations, disabled pensioners, and survivor pensioners. It is observed that over 60 percent of those surveyed were aged 65 or more. From the survey data it is evident that the largest number of pensioners (51.5 percent) live in families with over seven members, while 3.6 percent live alone. The largest number of these pensioners live in family houses or apartments (90 percent); 4.6 percent are without their own home, 2.7 own a house or apartment and the remaining 2.7 did not answer the question. From those surveyed, 95.4 percent declared that they do not receive any pensions (see box 2).

The main sources of financial support for these pensioners are from the family support. The structure of these sources is best seen from the survey results (see figure 3).

Figure 3 Financial Support for Older Pensioners (65-years-old and older)



Source: Riinvest survey.

Box 2 Interview with a pensioner housewife

I am 54-years-old and I am rightly entitled to a pension of a kind—a family pension—as my husband died and I have the right to his pension as his widow. I received the pension until 1999, just before the beginning of the war. Following the war and upon our return to our homes this question as far as I know has not even been discussed, not to mention receiving pensions.

I was entitled to a pension in 1982, only two to three months after my husband's death. At that time I really needed that pension as my husband left me at a time when I mostly needed him, at a time when our children were only beginning to grow up. I had five children, all of them boys. In the beginning I thought I would never be able to raise even three of them. But thank God they are all able to care for themselves. So, during the time that my children depended on me, I received the pension, and today although I no longer receive pension they are working and are supporting me. My position is not so threatened, but my health is not very well and I must ask my children for money all the time. I am saddened by the fact that the question of pensions is not discussed at all. I would point out that regardless of the fact that my children are working, and not all of them, two of them with an average income, and we are six in the family, life is very expensive and we barely make ends meet. If I had a pension, little as it might be, and if covered only my personal needs, that would suffice.

I think there are various ways of ensuring pension funds. First, I think a percentage should be shared from customs duties and taxation for pensioners, and contributions from current workers. There exist other forms that I don't remember right now, or better I am not very much informed as which are the adequate forms for creating such a fund, as I am also uneducated, I am just a housewife. But I know that a law should envisage all of these, including pensions in a realistic way, so that pensioners would feel more comfortable.

The survey indicates that 42.7 percent of the pensioners in families with no wage-earners, 53.6 percent are in families with one wage-earner; and 3.6 percent are in families with two to three wage-earners.

Over 90 percent of the surveyed pensioners considered that affordability of food was a top priority, while clothing, energy, and other needs are of a lower priority. According to the survey, around 7 percent of the pensioners' budgets is spent on health care and that over 65 percent of pensioners consider themselves to be in bad health. In 83 percent of the cases the family provides for health-care costs, while 11 percent social insurance pays for these costs. Pensioners receiving funds from abroad constitute a 2.7 percent of the surveyed population. The dire strait some pensioners find themselves in is evident from the interview with a retired teacher (see box 3).

Box 3 Interview with a retired teacher

The person interviewed (M. H.) is in her sixties, and has been retired since 1991. She worked for 30 years as a teacher in various parts of Kosovo. In her first years receiving a pension she was the head-of family. During the years from 1991–98 the largest pension she received as DM 150 per month, and the lowest was DM 3.

M. H. receives an early retirement pension. She chose for early retirement was to secure an income, because at that time education in Kosovo faced financial difficulties due to the expulsion of Albanian school children from their schools.

For two years she has not received her pension, so her children have supported her. In answer to the question what if tomorrow she should have to take care of herself she says in despair: "I would be forced to work at this old age any kind of job to keep myself alive."

M. H. says that she misses the staff with which she worked but she also points out the lack of adequate social care for this endangered layer of society.

Part of her free time she spends with the Association of Women Pensioners - VITA - where she has friends of her own age; they visit various places in Kosovo and talk about issues that concern them all.

She is partly informed with regard to the "Draft Regulation," and she points to the media, in particular the electronic media, as the source of her information. The respondent thinks the UNMIK engagement was lacking on the issue, and paying pensions for those aged over age of 65 she sees as incomplete, since she is still quite a bit younger than that. She thinks the problem can be solved with the return of Kosovar assets from Serbia, income realized from taxes and duties, and with a greater involvement of the international and local factors on the issue. In the end she hopes that this interview will have the effect of at least helping in her getting her deserved pension.

In the course of preparing this report, Riinvest Institute met with representatives from the Pensioners Association of Kosovo and representatives from the Disabled Pensioners' Association to discuss the proposed "Draft Regulation". The basic complaint of these representatives was about the low expected level of pensions and exclusion disabled pensioners from the system. A very difficult problem that will demand very special treatment is that of the individuals below 65 years of age who previously had enjoyed the right to a pension. Similarly, some 28,000 disabled pensioners are particularly affected in this way. Though some of them may be eligible for the general social assistance available from the Department of Labour and Social Welfare, special political consideration should be given to addressing this issue in the future.

3.3. The New System of Pensions in Kosovo

The current circumstances of the elderly, and of others who are or will soon become eligible for a pension, urgently demands that a pension system be developed.

Kosovo has no functioning pension system at present, and the new system will have to be built from the concept stage. The design of the new pension system will have to be consistent with the goals of developing an open market economy, with principles of the rule of law, social justice, and incorporating the trend toward globalization of economy.

The conditions of the low level of economic development, a high unemployment rate and the consequences of the war offer limited resources for building a pension system. The Kosovar public is concerned about creating a social safety net in the form of a pension system; however, there is a very limited public discussion about the possible solutions. The survey of pensioners indicates that they are inadequately informed regarding the current proposals for the development of the pension system. About 30 percent of the pensioners are unaware of the propsal, 50 percent have some awareness through exposure to the media, and remaining 20 percent have some awareness through the information received from the pensioners' association.

Similar to the pension systems of countries in transition, a system in Kosovo should be built on the three pillars, as follows:

1. Basic pension
2. Pensions based on capitalized contributions (Defined-Contribution-based system)

3. Voluntary pension schemes financed through additional contributions by firms and individuals.

Generally, there are two basic forms of financing pensions: the pay-as-you-go (PAYG) system and the Fully Funded system, or system of savings pensions.

The new pension system in Kosovo is expected to be built on the basis of contributions to individual accounts. The contributions to this system are invested in a financial portfolio, and the level of pension benefit depends on paid contributions and gains earned from the investment of these funds. The most recognized system of contribuition-based pensions has been introduced in Chile. Some European countries, including Croatia, Hungary, Latvia, Poland, and Sweden, have applied the similar concept in reforming their retirement systems.

3.4. Sources of Financing Pensions

For generating funds for pensions in Kosovo, a number of proposals have come from the survey of pensioners, from meetings with the representatives of the Pensioners' Association, the representatives of the former Kosovo Social Insurance Fund (KSIF)[7], and several experts in the field. The possible sources of funds that were indicated during these meetings include personal income contributions, general revenues, excise taxes, foreign donations, and the proceeds of the privatization process. In fact, the only source of funds, according to the former legal regulation, were contributions that were characterized with a relatively high percent of 16 to 21.7 percent and although the benefit level in Yugoslav system was relatively high, the coverage was low since not all those eligible for pension were able to participate in the old pension system.

Riinvest considers the policy suggested by UNMIK is appropriate; this policy assumes that basic pensions would be financed from general budget revenues, while pensions from the second and the third pillars would be financed from the contributions. Considering the limited capacity of the Kosovo's budget to pay adequate level of basic pensions, use of some portion of the proceeds of privatization deserves to be given a political consideration.

In some countries in transition it is a practice to ensure that part of the funds generated from privatization of socially owned or state-owned enterprises should be transferred to financing pensions. In Kosovo, pensioners contributed to the socially owned enterprises as their employees. Other citizens through taxes also contributed to these enterprises (farmers, independent business owners, state administration, and so on) helping to build the overall economic and non-economic infrastructure in Kosovo. The experience of other countries suggests that a part of the proceeds of privatization could be used as a supplementary financing source for the old-age pensions.

The sources of funding the pensions in the three pension pillars in Kosovo will be as follows:

1. First Pillar—The basic pension:
   - Overall revenues of Kosovo's budget;
   - In the future, proceeds from privatization.
2. Second Pillar—Pensions based on mandatory contributions:
   - Employee contributions of 5 percent of their salaries;
   - Employer contributions of 5 percent of the employees' payroll;
   - Returns from investing the pension assets.
3. Third Pillar—Voluntary Pension Funds:
   - Voluntary contributions by individuals;
   - Additional contributions by employers to their employees;
   - Returns from investing the pension assets.

3.5. Features of the System of Savings Pensions

In the fully funded pillar, contributions are invested in a financial portfolio, which provides a source of the supplementary income when participant retires. The basic advantages of this system are the following:

- Strong link between contribution and benefit; assets are considered to be an exclusive propoerty of the insured;
- Improved participation incentives and enhanced individual accountability;
- Higher expected return;
- Neutralized impact of demographic dependency on individual pensions;
- Facilitation of private savings and economic development.

However, the policymaking process should also consider the following factors related to the funded pillar operations:

- Higher uncertainty regarding the real level of future pensions; this level depends on the long-term benefits of the investment of shared contributions.
- Pensioners who depend on this system are not fully insured in case of disability retirement, particularly in cases when they have not worked for and contributed to the system for long period of time.
- Generally higher administrative costs.[8]

3.6. Current Activities in Building the Pension System

In 2001 the issue of establishing the pension system in Kosovo was actively discussed by the CFA, other UNMIK bodies, the World Bank, and the ILO. In the report presented by both ILO[9] and UNMIK an important observation is made on the position of pensioners and preconditions for building a new system of pensions. The World Bank report on the evaluation of poverty in Kosovo [10], presented in October 2001, has addressed this issue from the social perspective.

The former Kosovo Social Insurance Fund and the Pensioners' Association were also involved in building a new pension system by offering their professional services and data on the problems of existing pensioners.

UNMIK and the CFA have been working intensively to develop a proposal for a pension system for Kosovo. A radical departure from the old pension system aims to create a new system based on the experience of Western countries and countries in transition. This will lay the foundations for a sustainable system that will address the most urgent needs of the Kosovo's retirees by providing them with significant -- although limited -- benefits; in time, though, its effects will grow and Kosovo will be able to avoid many problems that many developed countries and countries in transition are currently facing.

The set of the CFA policy recommendations suggests that the pension system in Kosovo should comprise the following three pillars:

1. The first pillar would be the basic pension: a pension that the Pension Administration pays to all residents of Kosovo when they reach the age of 65. This kind of pension would be financed by the Kosovo Consolidated Budget and would be administered by the Ministry of Labour and Social Welfare.
2. The second pillar would be a system of savings pensions financed by the employer and the employee mandatory contributions that would be accumulated and managed by the Pension Savings Trust of Kosovo and that would be paid to all the participants on they reach the age of 65.
3. The third pillar would be a supplementary system of the employees' voluntary contributions to the pension plans established by their employers or other companies.

3.7. Basic Pension

The Pensions and Benefits Administration (established as an administrative unit within the Ministry of Labor and Social Welfare) will pay a flat basic pension to all the residents of Kosovo who reach the age of 65. This kind of pension will be financed by the general revenues of Kosovo's budget. To finance the Basic Pension, the CFA will transfer funds that would be allocated in the Kosovo Consolidated Budget for Basic Pensions to the Administration.

According to the "Draft Regulation" the level of basic pension is determined according to the methodology adopted by the Parliament by applying the same level for all who qualify for the old-age pension. One of the variants discussed for determining the basic pension was also the one that the base sum will be equal to the cost of the food basket needed for ensuring 2100 calories a day for adults. The methodology for determining the level of benefit in each year will be presented to the Kosovo Assembly for approval.

The purpose of this pension is to ensure that all the elderly get sufficient income to make certain that they can afford basic consumption basket and that they can contribute to their family budgets. The methodology for this pensions would have to be developed that links the level of pension to the World Bank's figure for cost of monthly basic consumption basket (aproximately DM 55).

3.8. Individual Accounts Savings Pension

The “Draft Regulation” proposes the creation of a Kosovo Pension Savings Trust to administer individual savings pensions. The Trust would administer individual accounts of participants. It would act as an independent non-profit legal entity. The Trust ensures investment of savings and acts on behalf of participants. A special governing board, composed of the head of the CFA, a representative of employers, a representative of the employees, and four experts who have international asset management experience, would manage the Trust.

Payment of contributions to finance this kind of pension, according to the “Draft Regulation”, is obligatory for both the employer and employees, who are mandated to make such contributions starting on the first day the employee starts working. The aggregate contribution for savings pension equals the sum of 10 percent of payments: employers pay 5 percent of the payroll of all employees and the employee pays 5 percent of his own salary. On a voluntary basis both the employer and employee can pay a higher percentage up to a determined maximum.

The Governing Board of the Trust will determine the instructions, including the part of assets to be invested locally and internationally, and ways of selecting more moderate investments for older participants. The assets will be managed by an Asset Management Company, to be selected through public tender. The governing board will provide clear guidelines and instructions for asset investment, including the standards with which investments are limited only to the instruments considered moderate for pension investments.

The Trust will also select a custodian through a public tender. The custodian may be a bank with a status of legal person licensed in Kosovo or a foreign bank branch authorized to do business with and licensed by a central bank regulation of the OECD member state. In both cases it must meet the conditions as laid down by the Banking and Payments Authority of Kosovo (BPK) in regulating banking management.

The accumulation of the pension assets represents an important momentum in the economic development of Kosovo, - these assets can be used in future for investments domestically. The assets accumulated under this system will have modest effect on an overall level of pensions and the investing activity in the initial years, but these assets will grow in time, and, together with the assets of the voluntary funds, they will be able to make a significant contribution toward Kosovo’s development.

According to the "Draft Regulation", a relatively wide spectrum of options has been envisaged for investments of pension savings funds. The key requirements for the investments are as follows:

- Securing pension assets;
- Diversifying investments;
- Maximizing asset management efficiency; and
- Maintaining adequate liquidity.

According to the draft regulation the possibilities of investing these assets in international financial institutions will be:

- Monetary assets, including bank accounts and bank deposits licensed by the central bank of the member state of OECD;
- Securities issued by the state – OECD member;
- Securities issued by local governments in countries that are OECD members to the degree to which they are guaranteed by the respective state;
- Securities registered with the regulator of capital market of any OECD member state; and
- Mutual and investment funds depending on approval by the state institution that is an OECD member.

In Kosovo the savings pension assets could be invested as follows:

- Monetary funds, including bank accounts and bank deposits as licensed by the BPK, but which are not under enforced measures and that are not subject to removal of licensing;
- Securities issued by the government of Kosovo, to the measure to which they are guaranteed by Kosovo's government;
- Securities of enterprises registered in the capital markets of Kosovo and offered through a public offer providing that such securities would be quoted in the stock market in Kosovo or in some other jurisdiction of OECD member state; and
- Mutual and investment funds depending from approval of regulation in Kosovo.

To secure pension assets, short-term investment strategies will most likely assume dominant investments overseas; in the longer run the proportion of investments in local assets will increase. Our assessments show that in future gradual expansion of investments of these assets domestically will be an important factor for Kosovo's developmet; in particular it will bring about the following benefits:

- Facilitation of creation and development of domestic capital market, and
- Encouraging investing and restructuring activities, particularly in the SME sector that has demostrated good investment perfomance and a fair discipline in repaying loans to banks and to other non-banking financial institutions.

The "Draft Regulation" also defines methods of paying savings pensions through the licensed insurance companies; such companies may be selected by each person who becomes eligible for such pension. The licensing procedure of these companies is determined by the CFA.

3.9. Employer and Individual Supplementary Pensions

This pillar of pension is formed by voluntary contributions. A special department of pensions at the BPK will regulate employer and individual supplementary pensions. The department would license and supervise employer and individual supplementary pensions; would have the right to end and annul licensing of funds; would audit their annual reports, issue rules in accordance with the pension regulation, and carry out other important tasks related to supervision of the voluntary pension schemes.

To provide the opportunity for investing with a supplementary pension plan, the fund would have to be established through a charter signed by the highest governing body of the employer establishing the scheme. The BPK Pension Department will approve the content of each charter by requiring that it meet the department's standards. The Pension Fund assets comprise contributions with or in the interest of the Fund participants and investments made with those contributions. The section of the "Draft Regulation" on employer supplementary pensions regulates licensing of this kind of pension, investment, and custodian activities of these funds, procedures for assets transfer and ending of the Fund.

According to the regulation, each person may open an individual pension account for his or her own self. This could be done by signing a contract with a licensed bank, another financial institution, or a licensed insurance company. Financial institutions offering individual supplementary pensions should have these pension plans established according to the pension regulations. The "Draft Regulation" provides a regulatory framework for licensing and supervising individual supplementary pensions, for the transfer of these pensions, and for terminating individual supplementary pensions.

4. PENSION SYSTEM REFORM AND EXPERIENCE OF OTHER COUNTRIES

In order to find ways to build a sustainable pension system, the experiences of the EU countries and countries in transition have been studied. The objective is to build a system in Kosovo that is sustainable in the long run. Since economic interests of Kosovo are tied to the EU and to the United States the pension system and policy of Kosovo must hormonize wih their systems.

The current pension system in the EU countries is based on the principles of PAYG system, as it is in many other countries. The essence of this system lies in the way that the current generation of employees, through their contributions, finance pension payments to existing pensioners. These employees on their retirement will in turn have their future pensions financed by the future generations, though the contributing employees could face demographic changes and economic risks in the future. This system is known also as a system of "intergenerational solidarity".

The changes in the population age structure, including the increase in the proportion of those over 65-years-old are considered important economic and social factors in economic analyses and fiscal projections in most countries of the world. The most important factors are: the dropping fertility rates, on the one hand, and the increase in life expectancy, on the other hand. According to the World Bank projections a trend of falling fertility is evident worldwide.[11] The fertility rate in the year 2040 is expected to be at around 2 in OECD countries, Central and Eastern Europe, and Asia, and at 2.5 in Africa[12]. The most significant decrease is expected to be in Africa and Latin America, where fertility in 1970 that was over 6.5; in 2000 ithas already decreased to 5 in Africa, and to 3.3 in Latin America.

The life expectancy of populations of OECD countries is expected to increase from 78 years in the year 2000 to 84 years in the year 2040. During this period, in Central and Eastern Europe life expectancy is expected to increase from 65 to 75 years, and in Africa from 44 to 64 years.

It has been estimated that in the EU currently there are over four employed persons for each person over the age of 65: that is, a ratio of 4:1. Projections carried out within the EU show that by the year 2030 this proportion will fall to 2:1, and in 2050 the proportion is estimated at 1.5:1. Based on these data, around 16 percent of the population of Western Europe is above 65 years of age, and by 2030 the population in this category will be at about 25 percent of the total. According to OECD assessments, in Germany in 2040 this age group will increase to 40 percent of the population. In this emerging scenario the social security taxes have been already high in many EU countries, and in many more countries the pressure of raising the tax rate will be growing (see table 3).

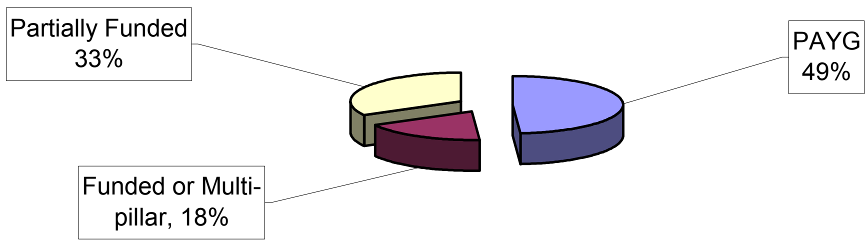
Table 3 Social Security Taxes in Selected OECD Countries in mid-1990s

Countries	As percentage of gross salaries			
	Pension Tax		General Social Tax	
	Employer	Employee	Total	General social security tax
United States	6.2	6.2	12.4	21.0
Austria	12.6	10.3	22.8	45.0
Canada	3.0	3.0	6.0	15.2
Germany	10.2	10.2	20.3	42.0
Italy	21.3	8.3	29.6	56.7
Japan	8.3	8.3	16.5	29.1
Holland	0.0	32.1	32.1	56.0
Sweden	19.0	1.0	20.0	24.9
Switzerland	4.9	4.9	9.8	19.3

Source: United States Department of Health and Human Services. Social Security Programs thoughout the World 1997. Robert Palacios and Montserrat Palleres-Miralles, *International Patterns of Pension Provision*, April 2000.

Thus, financing old age–pensions creates a considerable challenge that is growing in magnitude. As a set of solutions to the social problems of the retirees in many countries both mandatory and voluntary forms of pensions are applied. Generally, from the practice of all countries, 49 percent of the mandatory pension systems operate as the PAYG schemes, and 51 percent include all other forms of pension systems (see figure 4).

Figure 4 Mandatory Pension Plans in the World.



Notes: PAYG - "Pay-As-You-Go" transfer-based systems; Partially Funded - PAYG systems with invested reserves; Funded or Multi-pillar - System with investment of pension contributions.
Source: Robert Palacios and Monserrat Pallares-Millares: International Patterns of Pension Provision, World Bank, April 2000.

The value of assets created by the mandatory system alone reached US$7.5 trillion in the year 1997, or 26 percent of global GDP. Growth of pension funds in the period from 1990–96 was 10.9 percent annnually.

As seen in table 4, the pension assets in Denmark, Great Britain, the Netherlands, Sweden, and Switzerland exceed the GDP. In the EU there is a growing conviction that the system based on the solidarity of generation is not sustainable in the long run.

The Netherlands in 1996 entirely privatized the state pension fund with capital of US$140 billion, and 2.5 million members. Thus, the Netherlands privatized around 85 percent of pension funds. Great Britain began in 1988 implementing tax breaks for individuals who invest in pension plans. Germany became concerned with the rapid growth of its population over 65 years old. The private pensions industry has consolidated a large share of the private savings in the economy, and these savings will be directed to finace future retirement. Germany envisages establishing 75 pension funds Altersvorsorge-Sondervermogen (AS) as investing funds destined for capitalized savings for retirement. These savings are exempt from taxes; therefore it is estimated that on this basis the German budget will lose DM 60 billion annually. In 1999 the pension payments in Germany reached DM 590 billion.

Table 4 Population and Pension Fund Properties in EU Countries

Country	Number of inhabitants (millions)	Dependency rate +	Pension assets, USD bln	Pension assets, as percentage of GDP
Austria	8.1	22.1 %	26.7	12 %
Belgium	10.2	24.2 %	32.6	12 %
Denmark	5.3	22.4 %	187.0	198 %
Finland	5.2	22.7 %	60.0	41 %
France	59.1	24.6 %	64.1	4 %
Germany	82.	23.5 %	294.1	13 %
Ireland	3.7	16.7 %	45.9	47 %
Italy	57.7	25.0 %	250.0	20 %
Holland	15.87	18.8 %	607.0	141 %
Norway	4.5	25.0 %	49.9	31 %
Portugal	10.0	22.1 %	11.8	10 %
Spain	39.4	23.2 %	29.1	5 %
Sweden	8.9	26.6 %	270.5	107 %
Switzerland	7.1	22.4 %	306.2	117 %
Great Britain	59.4	24.6 %	144.5	101 %

Note: + Population over 65 years of age as a percent of the population aged 15–64 years.

Source: Financial Times, May, 2000.

In 1998 Italy began to allow the banks and large companies to organize their own private retirement plans. This followed a full revision of the pension system that was carried out in 1995. Pension assets could be invested in the U.S. securities.

Governments of these countries and of other European countries have taken more radical steps in changing their national pension systems. However, extensive supplementary pension schemes have been developed in many of these countries. Banks and insurance companies have been increasing their activities in offering various pension plans.

4.1. Experience of Pension Reform of Countries in Transition

One of the main social and economic features of transition in Central and Eastern Europe has been the crises in the pension system. These crises have arisen due to economic, political, and social difficulties. Such crises were reflected by a lack of funds to pay pensions. Experience of some countries in transition dealing with raising revenue through tax increase or with running budget deficit proved to be very expensive alternatives and resulted in a heavy burden of mounting deficit and national debt for economic reforms. Faced with such problems these states turned to pension reforms. From an economic perspective, there are various options of reform in these countries; their practices do not offer a universal model of a pension system.

By the late 1990s much of Central and Eastern Europe undertook pension reforms. However, their implementation varied considerably from country to country. In some countries, such as Hungary and Poland, new legislation has been implemented, while in others debate on reforms and legal regulative is still ongoing.

For Kosovo, studying international experience in establishing national pension systems can play a key role for success of the reform. In most countries, objectives have been focused on structuring a combination of pension schemes that would involve both the private and public sectors.

4.2. Public or Private Pension Scheme

Despite the fact that supporters of the private pension schemes in countries in transition offer many arguments on the benefits that workers gain in private system, most of the pension liabilities are concentrated in the public sector and are unfunded. It is also common that a substantial share of pension funds are initially invested in government bonds. Generally, during the initial phase of transition period in Eastern Europe, relatively little attention was paid to private pension systems. Initially these funds played an important economic role only in the Czech Republic and Hungary. In these systems (in 1997) in the Czech Republic 1.12 million persons were included, and in Hungary around 250.000 persons.[13]

However, options for investing pension assets have been quite limited. After introduction of the pension reform in Poland in 1999, 68 percent of workers' savings had been invested in government bonds, and 28 percent in corporate shares. In Hungary, such tendency is even more noticeable: approximately 85 percent of funds have been invested in government bonds, and 9 percent in corporate shares. In a similar way, the direction of a considerable part of private savings in non-private securities in Central and Eastern Europe is viewed as a reasonable strategy from the perspective of diversification, when considering the size of the private financial markets and their very fragile sustainability. Investing in government bonds in those countries helps to promote transparency at initial stages of the reform, and helps to finance the transition from the old PAYG system to the new funded system.

4.3. Social Security and Pension System in Countries in Transition

There is no unique approach among the countries in transition with regard to structuring the system of social security (table 5). These countries have developed their social policies depending on economic conditions and other features that have been, or are currently, accompanying their efforts to pull away from the state regulated system and to arrive at the market based system.

Table 5: Certain indicators of Social and Pension Security in various countries

COUNTRIES	BASE LEVEL OF CONTRIBUTIONS* (%)			BASE RETIREMENT AGE			LEVEL OF PENSIONS	
	TOTAL	EMPLOYEES	EMPLOYERS	MALE	FEMALE	YEARS OF CONTRIBUTION	MINIMUM US $	MAXIMUM US $
ALBANIA	**36**	**10**	**26**	**60**	**55**	**35**	**36**	**72**
ARMENIA	**31**	**3**	**28**	**62**	**57**	**25;20**	**5.4**	**7.6**
BULGARIA	**32**	**6.4**	**25.6**	**60.5**	**55.5**	**37.5; 32.5**	**21.7**	**75.4**
CROATIA	**21.5**	**10.75**	**10.75**	**60.5**	**55.5**	**19.5**	**177**	**560**
CZECH REPUBLIC	**26**	**6.5**	**19.5**	**60**	**55**	**25**	**70**	
ESTONIA	**20**	**0**	**20**	**62.5**	**57.5**	**15**	**30**	**NA**
KAZAKHSTAN[A]	**26**	**1**	**25**	**60.5**	**55**	**25;20**	**27.6**	**60**
KYRGYZTAN	**36**	**2**	**34**	**60**	**55**	**25;20**	**2.2**	**17.6**
LATVIA	**32.58**	**9**	**23.58**	**60**	**57**	**10**	**51**	**NA**
LITHUANIA	**24**	**1**	**23**	**62**	**60**	**30**	**19**	**NA**
ROMANIA	**28**	**5**	**23**	**60**	**55**	**30;25**	**24**	**NA**
RUSSIA	**29**	**1**	**28**	**60**	**55**	**25;20**	**5.2**	**15.6**
POLAND[B]	**32.52**	**16.26**	**16.26**	**65**	**60**	**25;20**	**132**	**692**
SLOVAK REPUBLIK	**27.5**	**5.9**	**21.6**	**60**	**53.57**	**25.20**	**93**	**189**
SLOVENIA[C]	**24.35**	**15.5**	**8.85**	**65**	**60**	**15;20**	**…**[D]	**…**[E]
KOSOVO[F]	**10**	**5**	**5**	**65**	**65**			

Notes: * Mandatory contributions for social insurance, with the exclusion of health care and unemployment insurance. + Former farmers and the self-employed.

a- Including 10% contributions to the funded pillar.
b- Including 7.3% contributions to the funded pillar.
c- Average contribution rate.
d- 35% in males and 40% in females of average income for 10 years in the interval from 1970
e -Maximum is 85% of gaining from insurance society.
f - UNMIK Documents: Draft Regulation on Pensions envisages 10% contribution to the funded pillar.
Source: US Social Security Administration; Volker Treichel: Financial Sustainability Reform options for the Albanian Pension Fund, International Monetary Found. Data refer to 1999, unless indicated otherwise. Kosovo has been added for comparison by Riinvest.

Countries in transition are characterized by various, but generally high, levels of contributions to the social insurance where pension contributions are also included. At the high end Albania is distinguished with 36 percent, followed by Latvia with 32.58 percent (23.58 percent employer and 9 percent employee), and Bulgaria with 32 percent (25.6 percent employer and 6.4 percent employee).

The retirement age in these countries is quite similar. Most countries established a retirement age of 60. However, this age is being increased to 65 in Slovenia and Poland. The age of 65 is expected to be used in Kosovo as well. The pressure for employment of a young active population leads to the policy of applying a younger retirement age in many countries.

The World Bank and the International Monetary Fund (IMF) have made important contributions to the reform of pension systems in countries in transition. The World Bank helped to define policies and activities in the process of the reform. It has been involved in pension system reforms in 30 countries, primarily through grants and technical assistance.

The World Bank supports a multi-pillar approach. The first pillar, financed by payroll taxes or general revenues, focuses on redistribution. The second pillar is a system where obligatory individual contributions are accumulated in a form of savings and are invested for paying out in form of pensions in future. The third pillar, voluntary retirement savings, allows individuals to select a source of their retirement income by allocation of their investments.

Characteristic of many countries in transition is a quite very low level of pensions relative to salaries. In table 6 the share of pensions in average salaries is presented. Compared to other countries, Kosovo's proposed basic pension level lags behind with respect to this indicator.

TABLE 6: REPLACEMENT RATES IN PUBLIC PENSION SCHEMES EASTERN EUROPE AND FORMER SOVIET UNION

COUNTRY	YEAR	AVERAGE PENSION AS SHARE OF AVERAGE WAGE [A]	MINIMUM PENSION AS SHARE OF AVERAGE WAGE [B]
ALBANIA		-	30
ARMENIA	1996	24.0	3.4
AZERBAIJAN	1996	29.0	-
BELARUS	1995	43.0	-
BULGARIA	1995	31.0	18.4
CROATIA	1997	48,7	34.6
CZECH REPUBLIC	1996	48.6	21.8
ESTONIA	1995	25.0	10
GEORGIA	1996	36.0	-
HUNGARY	1996	57.0	-
KAZAKHSTAN	1996	31.0	12.1
LATVIA	1994	62.8	19
LITHUANIA	-	-	6.7
MACEDONIA	1996	63.5	-
POLAND	1995	55.4	33.9
ROMANIA	1994	43.1	19.2
RUSSIA	-	-	9.5
SLOVENIA	1996	68.6	-
UKRAINE	1995	32.0	-
KOSOVO	2002	10.0	10

SOURCES: A- ROBERT PALACIOS AND MONSERRAT PALLARES-MILLARES: INTERNATIONAL PATTERNS OF PENSION PROVISION, WORLD BANK, APRIL 2000; B - IMF WORKING PAPER: FINANCIAL SUSTAINABILITY AND REFORM OPTIONS FOR THE ALBANIAN PENSION FUND, VOLKER TREICHEL, APRIL 2001

4.4. Unresolved Issues in the Pension Reform in Countries in Transition

There are a number of important issues in the countries of transitions that would have to be addressed in the future, which includes the following:

- Ways of paying out accumulated savings of the retired employee at the time of retirement and associated expenses. (Will there be several guarantee companies or one pension-guarantee company?).
- How will the average life expectancy of men and women be taken into consideration in establishing the pension benefit? (Female workers are usually at a disadvantage when retirement age for females is increased).
- How will the rights of all those who participated in the old system be recognized in the future?

- High taxes and inefficient taxation services provoke the move toward an informal economy leading to increase in informal employment.
- Social dialogue on the pension reform is limited in most of Central and Eastern Europe; three-party consensus by trade unions, experts, and government has not often been reached. This is a result of lack of tradition in reaching social consensus.

5. SOME MACROECONOMIC ISSUES RELATED TO THE PENSION SYSTEM

The effects of the proposed system in a macroeconomic picture of Kosovo may be viewed in the perspective of the impact that the budget and the fiscal policy might have on the GDP; or on the fact that Kosovo's budget in the long-term will face ficsal difficulties of paying basic pensions; and on the perspective of positive impact that this system might have in generating new investments.

Clearly, the share of basic pensions in Kosovo's budget will have an important specific weight and will have an impact on its restrcuturing. Although the level of pensions that will be generated from this pillar is very modest, because of the limited budget capacities, it will still be difficult initially to accomodate the inmrovement in that penion level; this is a problem for the current pensioners and those that will retire during the next 10 to 15 years. Young individuals participating in the savings-based system will not be immediately affected.

The growth of pension level is directly connected to the overall level of the budget. The share of the pensions in Kosovo's budget is projected to be around 5.1 percent in 2002. The currently expected level of pensions is in disharmony with the basket that ensures a minimum of calories per adult as declared by the World Bank and the ILO. Therefore, in order to improve the pension level it is appropriate to consider introducing a basic benefit level commensurate with the cost of a minimum consumption basket, which is approximately DM 55. Broadening the tax base would help to increase general revenues of the budget and capacity to finance pensions. In future, privatization may help to increse the funds to finance old-age pensions.

Lack of statistical data for basic macroeconomic indicators makes it difficult to make a meaningfull long term projections. However, based on some evaluations by the CFA, World Bank, and Riinvest, a simulation of basic relations between the GDP, payroll, budget, and pension funds was made, which helps to carry out budget planning and to asses the potential for development of the future financial market and investment activities in Kosovo. Table 7 presents a projection of these indicators for the next 3 years.

Injection of cash pension benefits into the underdeveloped and largely demonetized areas is going to have an important macroeconomic effect. Poor households will use this cash primarily for consumption of domestic products and services, which would have an overall positive effect on demand for products of the local producers and so would generate another development momentum.

Funds accumulated in the funded pillar will provide a potential source of financing for development of Kosovo in future when the privatization process releases opportunities for domestic investments. Such investments would have to meet all the safety and transparency standards.

Table 7 Macroeconomic aspects of pension system

	2000	2001	2002	2003	2004
GDP, 000 DM +	3000000	3700000	4300000	4700000	5200000
GDP Index	100	123	114.00	110.00	111.00
Budget Revenues, 000 DM	235000	538000	681000	792000	895000
Budget Revenues Index	100	229	127	116	113
Budget Revenues/GDP, %	7.8	14.8	17.0	18.6	18.5
Payroll, 000 DM ++	1,546,000	1731520	1904672	2057046	2201039
Farmers' payroll, 000 DM *	13,500	15120	16632	15600	16692
Payroll Index	100	112	110	108	107
No. of pensioners **	130000	131548	135718	140086	144429
Monthly benefit., DM			40 / 55 [a]	40 / 55 [b]	55
Basic pensions, 000 DM #			34500 / 74600[a]	67200/ 92400 [b]	95300
Pensions/GDP, %			0.8 / 1.7 [a]	1.4 / 2.0 [b]	1.8
Pensions/budget, %			5.1 / 11.0 [a]	8.5 / 11.7 [b]	10.7
Accumulations in Saving Pension Fund, 000 DM			35154	156661	287095

Notes: + Gross Domestic Product (GDP) in 2000 has been estimated by the IMF at around 3 billion DM, or per capita approximately DM 1.580 (estimated for a population of 1,9 million).
++308.000 employed persons have been considered, (according to Riinvest estimates) 135.000 in private enterprises, 50.000 in social enterprises, 48.000 in other services and 75.000 in public services, and average salaries according to the domain. The level of salaries is determined based on a survey by the Riinvest Institute , and on data from the Department of Labor and Social Policies of Kosovo.
* A number for farmers assumes 90,000 employed and a minimum DM 150 pay.
** Number of pensioners and their annual increase is based on UNMIK data.
# Basic pensions estimated based on the number of pensioners and the proposed sum as supposed on the table. For the year 2002 the pension is envisaged to be paid for 9 months.
a Assuming two alternative scenarios: benefit of DM 40 paid starting on March 1, 2002 to those who are aged over 70 and starting on October 1, 2000 to those aged between 65 and 69. The alternative budgeting arrangement assumes payment of flat monthly benefits of DM55 to all those aged over 65 starting from March 1, 2002.
b Assuming two alternative monthly benefit levels: DM 40 and DM 55.
? Based on the CFA estimates (cumulative numbers), and assuming that only employees of Government, SOEs, public enterprises, and large enterprises will be mandated to join the system in 2002.
Source: Riinvest Institute Evaluations based on its studies, CFA data, and World Bank and IMF reports.

Table 8 Share of pension expenditures in GDP in certain countries

Countries	Population 60+ over population 20–59	Year	Pension expenditures as share of GDP
United States	29	1995	5.36
Germany	35.7	1995	10.29
Sweden	41	1995	8.17
Kosovo +	17.7	2002	0.8
Albania	18,5	1995	5.1
Poland	29.4	1995	15.0
Hungary	35.7	1996	10.3
Israel	12.1	1996	5.9
Algeria	13.0	1997	2.1
Chile	17.5	1993	5.8
Bolivia	16.2	1995	2.5
Benin	11.5	1997	0.4
Nigeria	10.2	1991	0.1
China	17.2	1996	2.7
Vietnam	16.1	1998	1.6

Note: + Funds allocated to payment for Basic Pensions in 2002.

Source: IMF data, data for Kosovo comes from CFA

As seen from table 8, pensions share in GDPs in developed countries and countries in transition varies. A lower share is evident in Latin America and the Caribbean, Africa, and Asia, including East Asia and Pacific.

In OECD countries, during 1995 and 1996 the share of pension expenses in GDPs was 15 percent in Italy, 14.9 in Austria, 13.3 in France, 12.6 percent in Luxemburg, 7.2 in Switzerland, 6.6 percent in Japan, 5.4 in Canada, and 4.6 percent in Australia[14]. In Kosovo the share of pension expenditures in GDP remains low.

6. Challenges of Pension Management and Administration

The proposed pension system requires a development of managerial capacities of pension administrators (Pension Administration at the Department of Labour and Social Welfare, Pension Trust, BPK, and so on). This administrative and managerial structure should be established from the beginning. Employees of former pension administration within the Pension Insurance Fund will have a new set of tasks. This will increase the need for a complex program for local capacity building along with involvement of international assistance.

There are a number of managerial, administrative and infrastructure difficulties that will constrain the potential for efficient development and administration of the social security system in Kosovo. There is a pressing need to significantly improve Kosovar managerial and administrative capacity in the social security domain (and probably in the public sector generally).

Key managerial skills that are needed include: strategic business planning, general management, project management, financial management and human resource management. These skills need to be supplemented by education in the area of international social security, which will provide exposure to modern thinking and trends in social security. Administrative skills associated with using modern administrative technologies require strengthening. These skills include: Information and Communications Technologies (ICT) usage, customer service, taking individual responsibility, work scheduling, and team skills.

The present condition of the national communications infrastructure will also constrain best practice administration and will add costs to the implementation of social security programs. For example, an inadequate postal address system means that communications with social welfare clients will be difficult. Furthermore, the lack of capacity within the post office network (and the prevailing security problems with cash transit and storage) means that benefit payment delivery service options are narrowed. The short-to-medium term development of ICT systems that will link regional and local centers with headquarters will be significantly hampered by the incapacity of the current telecommunications systems.

ANNEX I. REFORM OF THE PENSION SYSTEM OF MACEDONIA*

by Aleksandra Naceva[15]

The private pension funds in time will become dominant "players" on the Macedonian capital market. As carriers of the compulsory pension insurance, they will provide the citizens with a secure and profitable channel of investing their savings, while as institutional investors they will "stir" the capital market in the country.

Similar to many other European economies, Macedonia is halfway through the demographic transformation that will result in a drastic increase in the older population with relation to the working population. This proportion, often referred to as "degree of dependence," is 25 percent now, but is expected to rapidly increase to 35 percent by 2020, to 50 percent by 2040, and perhaps to 60 percent by 2060.[16]

The population's becoming older will have a significant impact on the compulsory pension system of the country that will be financed on what is known as the PAYG basis. In the PAYG system, contributions are collected from the insurees in the system and are promptly transferred for repayment of pensions to the current pensioners. This system is easily financed when the proportion of pensioners to insurees is close, while financing problems emerge when there is a gap in the proportion. The demographic changes (caused by the birthrate decline and the extended life expectancy of the population, as well as the high unemployment rate) will result in an increased proportion of pensioners to insurees in the Republic of Macedonia, which will intensify the fiscal pressure on the system (the budget revenues necessary to cover the pension system deficit will constantly rise). It is typical of governments to respond to the increased fiscal pressure by stepping up the contribution rate, by increasing the age limit for retirement, and by decreasing the replacement rate[17]. As these changes help ease the fiscal pressure, concurrently they render the system less attractive to its participants and increase the probability that employees will decide to undertake activities in the informal sector (in order to avoid payment of

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* The original English version was received from the author.

social contributions and taxes). Therefore, the pension reform that strongly tightens the conditions of the existing PAYG system is not a very enticing solution.

Many governments with PAYG systems have developed solutions to address demographic changes that are more adequate. Instead of strongly tightening the conditions of the existing PAYG system, these countries have changed the underlying structure of the pension system by way of redirecting themselves from a PAYG financed to a capital financed (or a combination of the two methods of financing) system. [18] Unlike the PAYG system, the capital-financed system is relatively immune against democratic changes. In a capital system, the contributions of every insuree are deposited into an individual investment account, instead of being transferred for payment of pensions to the current pensioners.

The funds from the individual accounts can be invested in bank deposits, government bonds, shares, and other financial instruments[19]. Upon an employee's reaching the age of retirement, these funds are transformed in annuities through which payment of pensions is made. Thus, each employee finances his own retirement and does not rely on the contributions transferred by the younger generations. As a result of having individual accounts, the capital-financed system is far less vulnerable to demographic changes than the PAYG system. It is even more significant that the establishment of the capital-financed system promotes the development of the capital market, thereby increasing the potential growth rate of the national economy.

Although the capital system is immune against a demographic risk, it is exposed to an investment risk. Capital markets are facing periods of low or even negative yield of investments, as well as periods of high yield. Although these risks may be lowered through the legal obligation of the pension funds to maintain diversified investment portfolios, and through a ban on investment in assets of high risk, still the investment risk cannot be fully eliminated on its own. [20] The elimination of the whole risk is also undesirable, since risk is a sound characteristic of capital markets motivating investors to take wise decisions and directing capital toward the most profitable projects and investments.

Taking into account all the advantages and disadvantages of the differing reform options, the Government of the Republic of Macedonia by adopting the Law on Modifications and Amendments to the Pension and Disability Insurance Law in March 2000, determined that the most suitable reform option is the gradual replacement of the PAYG system with a system of "three pillars." The three-pillar pension system will comprise:

- First pillar—compulsory, financed on a PAYG basis through which generation solidarity will be achieved.
- Second pillar—compulsory, financed on a capital basis.
- Third pillar—voluntary, financed on a capital basis.

The last two are to provide material security.[21] Thus, the participants in the new pension system (the compulsory part) will have two "legs" to stand on, so that if one of them weakens in time, the other will continue to support. The risks of the system will be well-balanced between the demographic and investment risk.

What follows is a presentation of the existing pension system, of the new "two-pillar compulsory" system, as well as of the plan for transition from the existing system toward the new reformed one.

According to the basic indicators presented in the table, the employee being an insuree of the one-pillar pension system pays 20 percent contribution rate in the PAYG system and obtains around 72–80 percent replacement rates when retiring (assuming complete years of service of around 35 to 40 years). The insuree of the second-pillar system pays 13 percent contribution rate in the PAYG system, and 7 percent contribution rate in the second pillar, which is then directly referred to the insuree's individual account. Upon retirement, the insuree gains around 30 percent replacement rate from the PAYG system, as a pension generated by translating the accumulated savings of the second-pillar system insuree into annuities. Based on conservative assumptions regarding the movement of the interest rates, the second pillar will be sufficient to generate a replacement rate of around 40–50 percent, while the total replacement rate of the insuree would range around 70–80 percent (30 percent of the first and 40–50 percent of the second pillar).

Table 9 Macedonia, Basic Indicators

Basic indicators	**Existing system**	**Two-pillar system**
Age of retirement, male	64	64
Age of retirement, female	Gradually increasing to 62	62
Contribution rate, pillar 1 (PAYG)	20%	13%
Contribution rate, pillar 2 (capital funded)	0%	7%
Total contribution rate	20%	20%
Projected replacement rate, pillar 1	72–80%	30%
Projected replacement rate, pillar 2	0%	40–50%
Total projected replacement rate	72–80%	70–80%

Notes:
1. The replacement rate is expressed as a percent of the net salary, while the contribution rate as a percent of the gross salary.
2. The replacement rate set out in the table is calculated for an employee that will spend all his years of service after 2003.
3. The replacement rate in the second pillar is calculated on the assumption that the market rates of yield are above the 2 percent salary rise.

Transition from a one-pillar to a two-pillar pension system

The transition to the new two-pillar system will be carried out gradually in the course of the next 50 years, during which time the existing one-pillar system and the new system will co-exist. The transition will commence in 2003 when all the employees will be given the option of entering the new system. Because the system requires that the employees renounce most of their acquired rights, it is expected that only the younger insurees under 35 years of age will transfer into the new system. The older insurees will probably remain in the existing one-pillar system. In time, an ever-increasing portion of the labor force will become included in the two-pillar system, especially because the participation in the new system of the newly employed is envisaged as compulsory. After approximately 25 years, most of the labor force will be insured in the new system and there will be the first outflow of pensioners from the two-pillar system. Gradually, between the twenty-fifth and fiftieth year of the reform, the participation of pensioners will change from 100 percent in the one-pillar to 50 percent in each of the two pillars ending up in 100 percent pensioners in the new system. Toward the fiftieth year of the reform the transition is expected to end, so that all the insurees and pensioners will be in the new system.

During the transition period, the government has the task of financing pensioners from the one-pillar system, but without access to the existing 20 percent contribution rate. Since each insuree of the two-pillar system will pay 7 percent contribution rate into the individual account of the second pillar, only 13 percent contribution rate will remain to finance the PAYG system. Therefore, as the labor force shifts from the one-pillar to the two-pillar system, the average contribution rate in the PAYG system will tumble form 20 percent to 13 percent. This fall will occur in the first half of the transition, between the first and the twenty-fifth year of transition. In the second half, from the twenty-fifth to the fiftieth year of the reform, the PAYG average replacement rate will turn downwards in the same manner in which the average contribution rate will fall in the reform's first half. Gradually, the average PAYG replacement rate for an insuree with all the years of service participating in the two-pillar system will decrease from 72 percent to 30 percent.

In consequence, during the first half of the reform, the PAYG system will come up against a fiscal pressure (deficit) resulting from the slide in the average contribution rate; in the second half of the reform this pressure will subside as a result of the decreased average replacement rate of the first pillar as the reform reaches a more mature period.

The actuary simulations point to the projections that the transition will be relatively easy requiring relatively modest financing through a public debt or through the Central Budget.[22] A moderate economic growth combined with tightened conditions in the PAYG system, such as increased age limit, are sufficient prerequisites for successful and relatively easy transition without any major financial problems.

Many countries have changed the underlying structure of the pension system in order to redirect themselves from a PAYG to a capital-financed (or a combination of the two methods of financing) system. Unlike the PAYG system, the capital-financed system is relatively immune against demographic changes.

The easy transition of the system is mainly due to the immaturity of the Macedonian PAYG pension system, which is quite evident when comparing this system with the one in Slovenia, for instance. Each country has a population of around 2 million, but the Macedonian pension system has a mere 235,000 pensioners, while the Slovenian one has around 460,000, which is nearly twice the number of the pensioners in our country. [23] As a result, Macedonia will bear a smaller burden of pensioners during its transition into the new two-pillar pension system.

In consequence, during the first half of the reform, the PAYG system will come up against a fiscal pressure (deficit) resulting from the slide in the average contribution rate, but in the second half of the reform this pressure will subside as a result of the decreased average replacement rate of the first pillar as the reform reaches a more mature period

The two-pillar system

Each insuree in the two-pillar system will have his own personal investment account. These accounts will be operated by private companies for pension fund management being subject to audit by the agency responsible for providing security for the funds of the second-pillar insurees. Each insuree will have the right to transfer his funds from one into another company for pension fund management (if the insuree is unsatisfied with the working of the company for pension fund management).

In order to manage the insurees' funds, each pension fund–management company will collect a commission (determined as a small percentage of the insurees' contributions). Each company will have the right to individually identify the percentage of commissions collected. Since more companies will compete with each other on the market for managing the insurees' funds, there will be sufficiently strong motivating factors to keep the commission at a relatively low level.

At the beginning, only two companies for pension fund management will be able to obtain authorization to manage the second-pillar contributions.[24] By means of limiting the number of companies on the market, the government seeks to attract large renowned companies to participate in the pension insurance market.[25]

Projections about the operations of the second pillar

In the initial stages of the reform, contributions flowing into the second pillar are estimated at 1 percent of GDP (around US$30 million). As the second pillar matures, the inflow of contributions will gradually accumulate and reach 2.5 percent of GDP on an annual level. The funds available to the second pillar will gradually increase to 10 percent of GDP by 2010. By

2020, the funds in the second pillar are projected to climb at US$1 billion (real value), while in the long term the funds will come to a standstill at around 100 percent of GDP.

The data in the table point to the fact that the private pension funds in time will become dominant "players" on the Macedonian capital market. As carriers of the compulsory pension insurance, they will provide the citizens with a secure and profitable channel of investing their savings, while as institutional investors they will "stir" the capital market in the country. By means of injecting substantial amounts in the economy, they will encourage the private sector and will increase the assets of the national economy, as well as this country's potential for economic growth and development.

Table 10 Macedonia, Second Pillar

	2003	2005	2010	2020	2030	2040	2050
Insurees in the second pillar (thousands)	120	141	245	448	586	588	564
Contributions to the second pillar (percent GDP)	0.7%	0.8%	1.3%	2.1%	2.6%	2.7%	2.7%
Funds in the second pillar (percent GDP)	0.7%	2.2%	7.5%	24.7%	50.5%	78.3%	95.7%
Contributions to the second pillar (in US$ million)	21	25	48	104	173	241	325
Funds in the second pillar (in US$ million)	21	70	276	1124	3365	7,012	11,518

Notes:

1. Real GDP growth = 3% a year 2. Real yield rates in the second pillar = 5% a year

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The views expressed are those of the author and do not necessarily represent those of the Ministry of Finance).

ANNEX II. NEW LAW ON PENSION AND INVALIDITY IN SLOVENIA[*]

by Dr. Joze Zagozen[26]

The system of pension and invalidity insurance in Sloveniahas inherited its structure from the system of former Yugoslavia.

It is about the system PAYG system, by whom there are no material reserves, which would be accumulated in the past and will capitalize in the present through various forms of investments.

That means that we have to simultaneously acquire as many contributions as community of pension and invalidity insurance requires at the end of the month. The rights for the insured persons are fixed—contributions, however, must be accommodated and are variable. There must always be sufficient number of contributions to support claims of the existing pensioners

The main condition for success of this system is the right proportion between the number of insured persons and the number of pensioners**.** Everything works well if this proportion is similar to the proportion between the active period and pension period. If this proportion is 3:1 when someone works for 40 years and lives in pension for 15 years, there are no difficulties. With time, when the system has matured, this proportion usually collapses. In Slovenia, for example, this proportion already collapsed, while in Kosovo it has not yet done so. When many young people are employed and we have few pensioners this system works perfect. But when the population ages, when the number of pensions increase faster than the number of newly employed people, we have to reform the system.

In Slovenia, there is a situation where number of pensioners grows faster then new employment. The number of insured persons times the average wage divided by the number of pensioners times the average pension equals the proportion that should be more then one.

The problem of collapsed proportion is being solved for the past five years in Slovenia with not increasing the contributions on wages, that contributions still remain under rational level

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[*] The original English version was received from the author

from the individual point of view. So 70 percent of the money for pensions accumulates from the contributions of insured people, 30 percent therefore accumulate with subsidies from the budget or from the taxes and contributions respectively. This socialising system is perfect for the newly formed countries, when there are many employees and few pensioners. Later on, this system becomes pyramid-structured, which is inconvenient for the pensioner if the deficit is not covered by the budget. If we are confronted with minimum fertility as it is in Slovenia now, then the system can easily fall apart.

Because of this, the investment-saving system is suggested for Slovenia. The variable is the level of pension and not the level of contributions of employees. This is the saving (capitalist) system instead of the present system, which is the arranging (socialist) system.

The insurance companies calculate average pension of individuals by dividing the accumulated or saved amount with expected average life period.

If we acknowledge that the investment system is better, we have a problem, because we cannot easily change the systems. If we were immediately to abolish the system, we would confront enormous problems. Although we do not have pension funds, we still have to pay the pension to those who earned them before. There is no free money for saving. By simultaneous payment, we also have to save. In Slovenia, therefore, we see the solution in compromise by which we could maintain both systems in the transition period. We would still have the old system, the so-called Pillar I, along with the new Pillar II. The function of the I. column would be to provide minimum social security, while that of the II. column would be to provide bonuses. Shares between these systems would depend on material possibilities. The most would represent contributions, which the individual pays (I.column); the second part (II.column) would consist from the savings of individual.

Of course, also even that compromise has doubtful components, first of all for the pensioners, less so for the active population. The pensioners are rightly afraid that savings will sooner or later result in lower pensions. If the pensioner dies before expected lifespan, the benefit goes to the insurance company but if he lives longer, the benefit goes to the insured person. Z

As for Kosovo, unlike in Slovenia, there is a demographic decline. For example, the human increment per year in the age bracket 45–55-years-old is 33,000 people. Meanwhile, the human increment in the age bracket of 5-years-old is only 17,000 people. If there is no saving, fewer people will have to earn pensions to support many more people.

The role of insurance companies will take specialized pension insurance companies, which will be organized as mutual funds where the investor has a free will about deciding when he will withdraw the savings. But when we speak about specialized pension insurance companies we must not neglect the role of the state, because the state is obliged to take care of the citizens and to encourage them to save. Citizens may withdraw the saved amount when they have reached the minimum age.

This system is quite appropriate for the countries where the ratio of the number of pensioners to the number of contributors is high. The individual return in such system depends on the advances in productivity and not on the number of the contributors.

While in Kosovo demographic situation is not so unfavourable, in Slovenia worsening demographic dependency is threatening the sustainability of the pension system; some solutions can be found in revision of the status of the privileged pensioners.

Somewhere, in some countries, also the voluntary Pillar III is being introduced which represents additional insurance (the population is free to decide for this insurance and is self-payable). What we call Pillar II in Slovenia, elsewhere is being called Pillar III. In all comparable countries there is a problem with savings. If the savings are relinquished to insured person, there is no money left for the current pension payment.

As a rule, all transition countries have confronted the phase of hard social distresses (that is, poverty). The pensions have fallen, and people have accepted this as one of the costs of the transition. Thus arose the need for savings. Here is the paradox: although there is no need to hurry in Kosovo for implementing the saving system, it would be easy to implement the system because there is a space for savings on the behalf of low pensions. Although there was a considerable reduction in number of those receiving pensions in Kosovo in the past, a new system can be introduced that addresses the issues of current retirees and the workers. . Of course, the process of development of concept for the new pension system in Kosovo would require a lot of efforts and should consider the state of current economic, institutional, and social development of the region.

ANNEX III. POLISH PENSION REFORM*

By Dr. Maciej Grabowski[27]

The current system has three pillars:

- First pillar: PAYG system, which is covered fully by state entity called ZUS (or Social Insurance Fund). ZUS collects contributions and pay pensions and rents to eligible persons;
- Second pillar: obligatory capital system. Contributions are delivered to Open Pension Funds (OPE) and are allocated to financial markets for future pensions;
- Third pillar: voluntary capital system. Contributions are collected directly by Pension Funds according to voluntary agreements signs with employees.

The rates and basic rules are shown in table 11.

Table 11 Pension Contributions in Polish Pension Reform,

	Employer, %	**Employee, %**	**Total, %**
Pension contribution	9.76	9.76	19.52
Rent contribution	6.50	6.50	13.00
Sickness contribution	—	2.45	2.45
Accident contribution	1.62	—	1.62
Total	17.88	18.71	36.59

Notes: The base of this contribution is the wage before taxation. The base of contributions is limited to 250 percent of the average salary. It means if a person earns more than 250 percent average salary, any amount that is higher than that is not a base for contribution calculations.

About 7.3 percent of pension contribution paid by employee is delivered to (OPE), if the employee is born after January 1, 1969, or if he declared and signed a contract with OPE and is born after December 31, 1948. The health contribution is collected separately (rate 7.5 percent)

This reform was introduced in 1999. Its main role was to replace PAYG system to diverse system with strong capital component. The reason behind it was to avoid crisis of state

* The original English version was received from the author

pension system due to demographic development. Polish society is aging rapidly and either contribution rate of the current employees would have to be increased or pensions would have to be reduced.

Previously, there was only PAYG system fully financed by ZUS, and state grants. The pension is calculated according to a complicated formula: contributions paid, years of employment, and so on. Presently, the average pension is about 60 percent of average salary (or 650 DM).

The first pillar is still financed by ZUS. It provides relatively small pensions. Its role will be smaller and smaller in future. The second pillar was set for young employees. It means that employees younger than 30-years-old (in 1999) are obligatory in second pillar (OPE members). Those who were middle-aged (between 31 and 50 years old) could join OPE, or stay with the old system. Today around 10 million employees (or two-thirds of all employees) are members of OPE. The third pillar is voluntary.

Both OPE and the pension funds are controlled by state control special bodies. They issue licenses for these funds and control if they follow rules of investment (assets allocations). One of the main rule for them is to allocate most of assets on domestic financial markets; other rule restricts share investment versus bonds, and so on. The other role of this state control agency is to secure competition among OPE and transparency rule for potential customers. Every contributor (employee) may change OPE if he wishes to do so.

The main objective of OPE is to manage capital from contributions. The first pension from second pillar will be paid in 2009. All OPE collected 15 billions zloty (or 8 billion DM—US?) in 2000, what is equivalent of 2 percent of Polish GDP. It is expected that in 2006 total assets of OPE will reach 100 billion zloty (or 12–13 percent—PKB), and in 2011 it will reach 200 billion zloty (or 20 percent PKB). Their role as investors on capital markets will be rising dramatically. Presently three major OPE have assumulated 60 percent of all assets of the industry.

ABBREVIATIONS AND ACRONYMS

AS	Altersvorsorge-Sondervermogen
BPK	Banking and Payments Authority of Kosovo
CFA	The Central Fiscal Authority of Kosovo
CIPE	Center for International Private Enterprises
EU	European Union
ICT	Information and Communications Technologies
ILO	International Labour Organisation
LSMS	Living Standard Measurement Survey
OECD	Organisation of Economic Co-operation and Development
PAYG	Pay-as-you-go system
SME	Small and medium enterprise
KSIF	Kosovo Social Insurance Fund
UNMIK	United Nations Interim Administration Mission in Kosovo
USAID	United States Agency for International Development

Endnotes

1. [1] "Pension" means a regular monthly payment made to a participant (or his family) for life, beginning at pension age, disability, or death of the participant.
2. World Bank estimates at the table on the topic Kosovo, evaluation of poverty, held in Prishtina on 11 October 2001, and ILO and UNMIK: "Toward a Strategy of Social Insurance in Kosovo," Prishtina, September 25, 2001.
3. Together with a migration component.
4. *Source*: Institute for Social Policies.
5. Data from Social Insurance Fund, SPI Sector: Orientating Program on pension payments of Kosovar pensioners, Prishtina, 01.06.2001.
6. Institute Riinvest: Economic Activities and Democratic Development of Kosovo, Prishtina, September 1998
7. KSIF is in the progress of transformation into the new institution, Pensions and Benefits Administration, that will operate as part of the Ministry of Labour and Social Welfare.
8. Comparison of administrative costs between the funded and the PAYG systems should be made, however, on the net basis, -- expected returns under both system have to be taken into account.
9. ILO and UNMIK: Strategy of Social Protection in Kosovo, "Toward a Strategy of Social Insurance in Kosovo," Prishtina, September 25, 2001.
10. World Bank: KOSOVO, Poverty Evaluation, 3 October 2001.
11. Robert Palacias and Monserrat Pallares-Millares: International Patterns of Pension Provision, World Bank, April 2000.
12. Fertility rate is defined as the number of live births that average women gives during her life.
13. Albanian Center for Economic Research: From world experience in the field of pensions, Tirana 1997.
14. Robert Palacios and Montserrat Palleres-Miralles: *International Patterns of Pension Provision*, April 2000
15. Aleksandra Naceva is Assistant to the Minister of Finance and a Head of the Insurance Supervision Department, and at the same time, Coordinator of the Public Administration Reform Project.
16. Source: Official Report for 2000, Actuary Unit in the Pension and Disability Insurance Fund of Macedonia
17. "Replacement rate" is defined as a percent in determining the pension from the pension base.
18. Countries that have already introduced fully financed pillar include Hungary, Poland, Kazakhstan, Chile, Argentina, and Bolivia.
19. Under the Law on Capital Financed Pension Insurance (the Law is in a parliamentary procedure) 14 financial instruments have been determined in which funds may be invested by the insurees of the new pension system.
20. Under the Law, investing funds by the insurees is strictly limited, and is in accordance with the principles of security, risk diversification and liquidity.
21. For the purpose of this article, the new pension system will be presented through the first two pillars functioning on a compulsory basis.
22. The simulations are taken from the Actuary Unit of the Pension and Disability Insurance Fund, in cooperation with the World Bank consultants working on the Project for Pension System Reform.
23. Information refers to 2000, source: Pension and Disability Insurance Fund of Macedonia
24. This limitation will be in force only during the first seven years of work of the companies for pension fund management
25. If a considerable number of companies are initially authorized to take part in the market, the market participation of each company will be minimal, while large companies will not be motivated to enter the market.
26. TER Ljubljana.
27. Institute Gdansk.