

A POLICY REPORT BY THE GROUP FOR LEGAL AND POLITICAL STUDIES

NO. 06 – DECEMBER 2012

Country Report

The Netherlands' pension system is often seen as the modern alternative for the rest of Europe. But even it is not immune to demographic changes and the eurozone crisis enveloping Europe.

Leading by Example

In the seventeenth century, the winds of change were blowing through Europe. European monarchies were characterized as absolute or more modern in nature, as were the Netherlands. When England harboured an ambition for a change of king, it looked to the Netherlands. With it came the revolution which brought the joint monarchy of English Queen Mary and her Dutch husband William of Orange to the throne, ridding England of an absolute monarch and replacing him with a more modern alternative.

Fast forward 300 years or so and it's not so much the Netherlands' monarchy but rather her pension system which could be seen as the modern alternative for the rest of Europe. Typically defined benefit in nature, its strength has been the capital based nature of its second pillar. But even this renowned pension system is not immune to demographic changes and the eurozone crisis enveloping Europe. The solution has been to shift risk to employees, but some condemn reform as a means of shifting burden to future generations of Dutch people. Whether they will be prepared to carry this burden is unclear.

The Dutch pension system is characterized by a three-pillar model: basic state old-age pension under a statutory insurance scheme (first pillar), supplementary pension schemes by virtue of the employer (second pillar) and private savings for retirement (third pillar).

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Pension System in Kosovo:

—Review of Current State, Main
Challenges and Gaps



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Policy Report 06/2012

Pension System in Kosovo: Review of Current State, Main Challenges and Gaps

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December 2012

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This publication is supported by:

United Nations Development Programme in Kosovo



PENSION SYSTEM IN KOSOVO: REVIEW OF CURRENT STATE, MAIN CHALLENGES AND GAPS

Introduction

Pensions are a mechanism to reduce the risks of poverty among the elderly and a means to ensure consistent lifetime income to maintain living standards throughout retirement; hence, pension policies have the greatest impact on the economic status of elderly people, and thus their risk of being affected by poverty and social exclusion during their lifetime.¹ Public pension schemes have several characteristics that make the occurrence of social exclusion and poverty less or more likely—consumption-smoothing, redistribution, and insurance being the system's main functions.²

It is of a great significance for pension systems to be sustainable, both fiscally and politically, in order to achieve their income-support objective. Ultimately, unsustainable pension systems can be an obstacle to fiscal stability and economic growth. As such, the pension system should promote the development of the labour market, suggesting that contribution rates be set at reasonable levels, and that pension programmes offer participants acceptable returns on their contributions so to provide incentives to participate. Owing to immediate pressure concerning the overall sustainability of the pension system model, mainly deriving from demographic changes, several post-communist countries, namely Macedonia, Croatia, and Bulgaria, have undergone various pension system-centred reforms.

The actual state of the pension system in Kosovo was determined in the 2001–2003 period, wherein the government authorities made a distinct move away from the solidarity system to a defined contribution system. A fundamentally new pension system has been designed and implemented without consideration for modifying existing schemes; thus, a tough and unfair transition was implemented, subsequently leaving a full generation of contributors with only a basic social 'pension'.

Markedly, the current system comprises of three pillars: Pillar I encompasses an old-age basic pension funded from general revenues rather than an earmarked wage tax paid to all Kosovars, 65 years of age and older, a disability pension, and early pension for Trepca workers; Pillar II of the system is a mandatory, defined-contribution (henceforth: DC), savings-pension programme; finally, Pillar III provides supplemental, individual or employer-sponsored pension schemes. The system has been designed on the basis of the clear division of functions, where Pillar I ensures poverty avoidance, and Pillar II and III serve as an instrument for supplementary savings.³ However, it is a huge challenge to develop a new system and establish a transition path which would be acceptable, sustainable and growth-enhancing for the current contributors. Thus, in practice, the newly designed pension system in Kosovo does not fully address the aforementioned functions through the three different financing and managerial arrangements (pillars).

With consideration to the current situation, one can argue that the system implemented presently fails largely to respect the principles/objectives upon which the reform was based. The

¹Andreas Hoff (2008) 'Tackling Poverty and Social Exclusion of Older People – Lessons from Europe', Working Paper 308, Oxford Institute of Aging. Oxford Institute of Ageing Working Papers

²Gubbels, J. Snelbecker, D. and Zezulin, L. (2007). The Kosovo Pension Reform: Achievements and Lessons. Social Protection The World Bank Discussion Paper No. 0707

³Gubbels, J. Snelbecker, D. and Zezulin, L. (2007). The Kosovo Pension Reform: Achievements and Lessons. Social Protection The World Bank Discussion Paper No. 0707.

absence of the law regulating state-funded pensions has, as a result of political negligence, resulted in the failure of Kosovo to build a pension system based on values and international/European standards. Such negligence of the government authorities has contributed further to a state of poor pensioners within Kosovo.

The current pension system covers a basic pension for all citizens aged 65 and above, irrespective of a history of earmarked contributions; however, this policy option does not eliminate exclusion, nor does it reduce poverty threat for the majority of the otherwise excluded population. As financial poverty is one of the main dimensions associated with social exclusion, by earning a pension that is insufficient to escape poverty, pensioners are also exposed to social exclusion. It is important to note that, in addition to the insufficiency of the basic pension, there are a number of challenges and gaps recognised as being inherent within the current pension system. Concerning future pensioners, the level of contributions collected and investment performance remain key factors contributing toward a decent pension. One of the key issues facing the pension system is the near-exclusion of various groups due to high levels of informality made manifest in the non-registration of employees which results in avoidance of contribution payments. The persistent unemployment constrains individuals from accumulating enough funds in KPST for a sufficient pension when retired. In view of this, adequate pension and proper mechanisms to insure the sufficient and regular collection of pension contributions are key elements for the social and financial state of individuals. Therefore, both civil actors and policymakers should direct attention and emphasis to the functionality and overall sustainability of the pension system of Kosovo, as a tool to ensure social inclusion and decrease the likelihood of old-age poverty.

Based on available data, documents, reports, information, legal documents and acts, and in-depth interviews, this Policy Report assesses the current pension system. It analyses the important issues that must be taken into account by the authorities and regulators responsible for the Kosovo pension reform. Firstly, this Policy Report reviews the current system of pension provision, briefly describing and analysing the reforms since 2002. Secondly, it identifies the main gaps and challenges inherent within the current pension system, as well as their current and future implications. It will indirectly also assess whether or not pension schemes have been used as a social inclusion strategy, and the extent of such social inclusion policies alongside their apparent impact on escaping poverty. Finally, the report will provide policy recommendations for further improvement, and if necessary, policy suggestions for the reforming of the pension system.

Pension System Reform in Kosovo: A Chronological Policy Background

Prior to the 1998 war, Kosovo was covered by the Yugoslav pension system, and regulated by the Federal law for fundamental rights for pension and invalidity insurance. The system, at that time, was a *generation solidarity* system, known as the 'pay-as-you-go' (PAYG) system, through which active workers paid contributions to fund the benefits of current pensioners. Pension levels were determined by a benefit formula based on years of service and salary level. Up until 1989, Kosovo had an autonomous *pension fund* that collected contributions and paid benefits. The pensions were administered by the Fund for Pension and Disability Insurance (known as BVI).

During the past 10 years, there has been a significant shift in pension systems of several post-communist countries, from the traditional PAYG system to the more contemporarily defined contribution schemes (DC schemes). From 2001 onwards, Kosovo initiated a comprehensive reform of the pension system, closing the chapter of the Yugoslavian system and introducing the construction of a completely new pension system. The establishment of the new system has divided functions so as to ensure both poverty-avoidance and savings tools for the new retired

generation. Of note is the fact that many aspects of the Kosovo reform are unique when compared alongside that of other countries.⁴ At the same time, a system with divided functions is regarded as highly relevant for many countries—particularly small countries with poorly developed capital markets.⁵ Other aspects include the nature and broad coverage⁶ of the basic pension paid from general revenues, the centralised nature of the authority that manages funds from contribution schemes, and the current practice of investing the majority of funds outside Kosovo.

As the old system provided rates of pensions of more than 60% of the average wage, most experts and officials involved in the reform considered it very high and costly, and only provided such high levels to a limited part of the elderly population. With that said, however, the reform took no account of the contributions prior to 2001; thus, irrespective of contributions, all retired persons were placed within the same category, meaning that the first pillar would be funded fully by the state budget, which theoretically makes it a social assistance rather than a pension. Most of the countries reformed their pension system due to the system's risk of low-sustainability (i.e. high dependency ratio)⁷ as well as to high levels of unemployment. As for Kosovo, the demographic situation has not been as alarming, as in other neighbouring countries, that it would threaten the sustainability of the system. Importantly, the population is young, and the number of basic pension beneficiaries in the system throughout the years has remained more-or-less the same. Although the projections estimate an increase of the population of 65 and older⁸ and a drop in fertility rates⁹, the situation would still be favourable in regard to sustaining a decent pension for the contributors of the previous system. Nevertheless, a pension based on contribution could have been sustained for at least some years in order to provide decent pensions for the former contributors; however, such possibility/opportunity has been largely neglected by the government.

The reform aimed to achieve a widespread reach compared with the Yugoslavian system, which covered only approximately half of the elderly population through its previous system. The decision to opt for a basic (flat) pension system was designed with the intention of avoiding discrimination based on work history, sex, or ethnicity. However, by not accounting for the past contributions and years of experience, such a category of pensioners is automatically discriminated against. Accordingly, Pillar I payments can be considered social assistance rather than pension benefits. On the other hand, Pillar II and Pillar III are aimed at producing a sufficient pension so as to help individuals escape old-age poverty. As the last two pillars are based mainly on contributions, individuals failing to do so on a regular basis—and for a long enough period of time—ultimately risk ending up with a largely insufficient 'pension'. Many risk remaining completely out of the contribution schemes, as they will fail to collect contributions with KPST.

⁴These aspects include the issues of Serbia's pension liabilities; the discontinuation of pension payments during late 1990s, which was another reason to switch to the new system; the governing structure at the time of reform, etc. Gubbels, J. Snelbecker, D. and Zezulin, L. (2007). The Kosovo Pension Reform: Achievements and Lessons. Social Protection The World Bank Discussion Paper No. 0707.

⁵ Ibid.

⁶ The new reform included in the system (Pillar I) also the elderly who had not participated in the old Yugoslav pension system, who had not been able to make contributions to any form of pension savings program.

⁷ This has been the case for many Central and Eastern European countries. See for more: International Labour Organisation (2011). Pension Reform in Central and Eastern Europe- in times of crisis, austerity and beyond. Budapest, 2011. ISBN 978-92-2-125640-3. Available at: http://www.ilo.org/public/english/region/eurpro/geneva/download/pension_reform_cee.pdf.

⁸Social Welfare Statistics 2010 and 2011, Kosovo Agency of Statistics. Available at: http://esk.rks-gov.net/publikimet/cat_view/33-statistikat-sociale/19-statistikat-e-mireqenies-dhe-shendetsise

⁹World Bank Fertility Rate Data 2007-2011. Available at: <http://data.worldbank.org/indicator/SP.DYN.TFRT.IN>

The Current Pension System in Kosovo

UNMIK Regulation 2001/35 of Pensions in Kosovo—which provided the legislative base for Pillars II and III—was the first act to regulate the pension policy in Kosovo after 1999. The regulation 2002/15¹⁰ laid the legislative foundation for Pillar I so as to allow for the entire three components of the system to become operational in 2002. In April of the same year, the Assembly approved the Law no. 2011/04-L-101 on Pension Funds of Kosovo, which abrogated the Regulation no. 2005/20 and Law no. 03/L-084¹¹. Thus, currently, the pension system comprises of three pillars, as follows:

- Pillar I: Basic and Disability Pension and Early Pensions for employees of TREPÇA
- Pillar II: Defined Contribution Scheme
- Pillar III: Voluntary schemes.

Pillar I:

Under these schemes, individuals who have reached the pension age of 65, as well as those individuals regarded as incompetent for work and/or physically disabled, are provided with a pension financed by the government revenues. The schemes under Pillar I are considered the basis of the pension system and a tool for poverty alleviation owing to the fact that the time span of contributions under Pillar II is too short to accumulate enough funds for a sufficient pension.¹² However, having more and more individuals benefiting from Pillar I leads to an increase in the heavy burden on the state budget, and risks the overall sustainability of the system. Thus, if the demographic trends are to be worsening, government authorities should consider finding other means for funding Pillar I benefits.

A basic pension is funded from the state budget, and is paid to all persons habitually residing in Kosovo who have reached the pensionable age. This scheme was designed to be universal and non-discriminative, covering every person who reached the age of 65 and older, irrespective of gender and past records. When first introduced, the same flat rate was applicable for every person who reached the pensionable age. A government decision in 2009¹³ introduced the categorisation that provided an extra 35€ for all retired individuals who had contributed at least 15 years before 1999. The extra 35€ is highly unsatisfactory, and does not account for the large contributions that the majority of pensioners have paid to the previous system. Moreover, those who do not meet the above criteria fail to be categorised under the group with increased pension (currently 80€), and are therefore entitled only to the basic pension that everyone else receives (45€). With this noted, the current legislation largely discriminates against those pensioners who failed to work/contribute for the 15 years leading up to 1999.

The methodology for determining the rate of the monthly benefit has been regulated by the regulation 2002/15.¹⁴ With this regulation, the pension is to be determined annually from the Ministry of Finance (MF), based on the minimum Consumption Food Basket that serves as a proxy/standard of basic consumption needs. However, despite the expected yearly indexation, the process is conditional on the sufficiency of funds from the budget.¹⁵ An increase in the rate of

¹⁰ This regulation amended the Pension Regulation 2001/35.

¹¹ Amending UNMIK Regulation 2005/20 Amending UNMIK Regulation 2001/35 on Kosovo Pensions TRUST

¹² Draft legislation for Pension Reform- Kosovo, Explanatory memorandum, 5 June 2010

¹³ Government decision no. 13/277, administrative guideline no. 11/2007 which was later replaced by the administrative guideline no. 15/2009.

¹⁴ Available at: http://www.unmikonline.org/regulations/unmikgazette/03albanian/A2002regs/RA2002_15.pdf

¹⁵ Given this condition, the basic pension scheme can be considered to have a kind of built-in sustainability.

pensions took place in 2003, 2004, and 2009; however, it can be considered as an ad-hoc increase rather than indexation. In 2011, this scheme covered 107,145 citizens under the basic age-based scheme, and 32,415 persons under the basic contribution-based scheme (see Table 1 and Table 2, respectively).

Table 1: Basic Scheme Pensions

Year	Number of Beneficiaries ¹⁶	Monthly Rate	Annual Budget Spent
2002	93.087	28€	17,874,763.00
2003	108.279	35€	44,459,960.00
2004	116.932	40€	54,193,599.00
2005	124.893	40€	59,133,333.00
2006	127.356	40€	63,766,380.00
2007	131.874	40€	63,133,100.00
2008	138.847	40€	65,641,485.00
2009	130,347	45€	73,603,960.00
2010	109,585	45€	63,640,920.00
2011	107.145	45€	61,196,210.00

Source: Ministry of Labour and Social Welfare

The Disability pension is regulated with law no. 2003/23; eligibility is determined by being declared permanently disable, which is a decision made by the Professional Medical Committee in MLSW. This condition is set with the aim of minimising the level of abuse seen under the old pension system. According to the Law, the disabled individual is entitled to the pension benefit until reaching the age of 65, when the disability pension is then replaced by the basic pension. In 2009, a new rate was announced; thus, the pension benefit was increased slightly from 40€ to 45€. This scheme covered 18,594 individuals in 2011, equating to a budget expenditure of 11,151,240€ (see Table 3).

Table 2: Contribution Based Scheme

Year	No. of Beneficiaries	Monthly Amount	Annual Budget Spent
2008	27,774	35€	11,286,910.00
2009	22,883	35€	12,104,470.00
2010	30,641	80€ (45€ + 35€)	30,899,760.00
2011	32,415	80€ (45€ + 35€)	31,670,450.00

Source: Ministry of Labour and Social Welfare

¹⁶ The number of beneficiaries presented in this table represents the number registered by authorities in the end of December of each year, respectively. Mr. Sami Salihu, Director of DAPK, explained that the number of beneficiaries varied from month to month for technical reasons-such as approval procedures which defers the payment of pension to a month or several- but also due to new entrants from month to month. (Personal communication, Prishtina, June 2012).

Table 3: Disability Pension Scheme

Year	No. Of Beneficiaries	Monthly Amount	Annual Budget Spent
2004	15.077	40€	7,248,160.00
2005	21.786	40€	15,480,160.00
2006	19.981	40€	14,795,396.00
2007	19.203	40€	10,089,562.00
2008	20.053	40€	10,022,300.00
2009	17.264	45€	11,460,218.57
2010	19.392	45€	11,432,940.00
2011	18.594	45€	11,151,240.00

Source: Ministry of Labour and Social Welfare

The early retirement disability pension for Trepca workers was introduced in 2004 by the Government decision no. 03/103 and Administrative Guideline (A.G) no. 2003/2 (later changed and replaced by A.G no. 02/2006). This scheme has been introduced in consideration of the relatively high on-job risk related to this profession. The scheme includes the ex-Trepca work-disabled individuals aged 50–65, declared as disabled by the Professional Medical Committee of the management of Trepca. The monthly rate paid to such beneficiaries was 50€ until 2011 when an increase of an additional 20€ was introduced, thus increasing the rate to 70€. In 2011, this scheme covered 4,096 individuals at a cost of 3,068,540€ to the budget of Kosovo (see Table 4).

The administration of the aforementioned schemes is governed by the Ministry of Labour and Social Welfare (MLSW), Department for Pension Administration (DAP). According to the current legislation,¹⁷ the Ministry of Labour and Social Welfare (MLSW) is responsible for drafting and implementing the basic and secondary laws for labour and social welfare. Ultimately, DAP is responsible for managing and administering the pensions and benefits of the schemes under Pillar I for all individuals reaching the pension age of 65.¹⁸ Currently, DAP administers only the pension benefits of the first pillar (basic pension or old-age pensions, and contribution pensions).

Table 4: The early retirement disability pension for Trepca workers

Year	Number of Beneficiaries	Monthly Amount	Annual Budget Spent
2004	4185	50€	1,770,420.00
2005	5077	50€	2,567,147.00
2006	4602	50€	2,951,920.00
2007	4627	50€	2,818,513.00
2008	4540	50€	2,775,750.00
2009	4249	50€	2,612,503.00
2010	4018	50€	2,471,860.00
2011	4096	70€	3,068,540.00

Source: Ministry of Labour and Social Welfare

¹⁷ Law No. 04/L-101 Pension Funds of Kosovo, Act 2.2

¹⁸ Law No. 04/L-101 Pension Funds of Kosovo, Act 3.7

Pillar II:

Pillar II is a mandatory, defined contributions and saving-pension scheme for all individuals aged 18 or over, and those born during or after 1946. Workers born before 1946 are eligible to contribute on a voluntary basis. The age restriction was set with the aim of exempting anyone 55 years of age and older at the time of programme commencement from mandatory contributions, owing to the fact that less than 10 years' contributions would be considered insufficient in terms of generating a satisfactory pension. The scheme was introduced in two phases: initially, it was introduced in August 2002 for workers in the public sector, in public enterprises, and in large firms; the second phase was adopted in August 2003 to include formally employed individuals in the private sector as well as the self-employed.

This scheme requires both the employer and employee to contribute a minimum of 5% of gross wage rate, as well as a further voluntary contribution of up to a maximum of 15% in total. According to the Law for Pension Funds of Kosovo (No. 04/L-101), the minimum level of pension contribution cannot be lower than the minimum wage set/proposed by the Economic and Social Committee and approved by the Prime Minister. With this noted, in consideration of this legislation, two new minimal wage rates were introduced: 1) minimal wage rate of 130€/month applicable to employees aged up to 35 years old; and 2) the minimal wage rate of 170€/month for employees aged between 35 and 65 years old. Thus, the contributors in Pillar II cannot earn less than 130€ and 170€ per month, respectively, as employers cannot declare an employee as having a wage amounting to less than the new minimum wage rates. However, to date, such a system has not yet been implemented.¹⁹

The contributions are transferred to the individual accounts of every contributor, and are invested on behalf of individuals by Kosovo Pension Savings Trust (KPST). However much the plan will ultimately give employees upon retiring depends entirely on the contribution accumulated and their investment performance. The contribution rate is fixed; however, the benefit is not. Thus, the entire investment risk falls on the contributor since KPST does not guarantee any compensation in the case of negative investment return. Nevertheless, contrary to other countries in the region, Kosovar contributors do not encounter high administrative fees, as shown in Table 8; on the contrary, they pay the lowest fees. The performance of KPST during recent years has been criticised significantly, mainly owing to large losses encountered in the financial markets as a result of the global financial crises during 2008–2009. However, KPST barely managed to close 2011 without losses, achieving only a 0.3% return.

Pillar II is administered by the Kosovo Pension Savings Trust (KPST)—an independent body established by the Assembly of Kosovo, and regulated and supervised by the Central Bank of Kosovo.²⁰ KPST is established exclusively for the purpose of administering and managing the savings/contributions of individual accounts, assuring the prudent investment and custody of Pension Assets, as well as paying the proceeds of Individual Accounts to purchase Annuities for Savings Pensions. Contributions are collected by the Tax Administration of Kosovo (TAK),²¹ and are transferred subsequently to the KPST. The funds contributed are administered by KPST;

¹⁹ Agron Krasniqi, Deputy Director, KPST, personal communication, July 2012

²⁰ The CBK has no authority to investigate KPST but holds the right to oversee the operations of the KPST to ensure that the best interests of participants are being met. Moreover, CBK also regulates how the KPST calculates investment return, and how it reports to participants on an annual basis. Concerning the benefit payment stage, the CBK is responsible for licensing and regulating annuity providers in Kosovo.

²¹ TAK by law holds rights and responsibilities concerning the inspection, evaluation and execution of contribution payments that ATK has regarding the income tax. This includes the right to evaluate the penalty etc.

however, the assets remain as the legal property of contributors. Markedly, the KPST establishes an individual account for every participant, and credits the account accordingly throughout the working life of the participant. Following the contributor reaching the pension age, the mandate of KPST ceases, and the individual becomes eligible for pension. Exemptions from this rule are the cases of those who receive the status of permanent disability before the age of 65, and the death of the contributor.²²

Considering that the nature of the scheme is based on defined-contribution, the pension payable at retirement will depend on the working-life contributions, investment returns, and net management costs.²³ At the point of retirement, the balance of funds in an individual's account is to be used to purchase an annuity—provided that the accumulated balance is sufficient to meet the minimum threshold of 2,000€. ²⁴ Where funds are insufficient to purchase an annuity, the regulation provides for the payment of a lump-sum benefit; however, as insurance companies have not been interested in providing such services, KPST has opened a bid for commercial banks that would offer the best interest rate for the accumulated contribution of the individual.²⁵ The first bank to win the tender was ProCredit Bank Kosovo, followed by NLB, which is continuing its second mandate this year, offering a 2.2% return.

KPST is staffed by Kosovar management and employs a Governing Board with a combination of local and foreign members. The election process for these members is governed by the Law for Pension Funds. Law no. 04/L-101²⁶ for Pension Funds regulates the powers and responsibilities of KPST, as well as the procedures, appointment of custodian, appointment of the Board of Directors, and provisions concerning investments, etc. Moreover, KPST is competent for appointing the asset managers and fund and instrument holders via procurement procedures and in strict consideration of law. Furthermore, more specifically, the Board of Directors of KPST holds the right to make decisions surrounding the investment strategy, as well as setting the administration fees, which need to be approved by the Parliament. Tax Administration Authority is the authority responsible for the collection and enforcement of pension contributions by using the extensive network of TAK's regional offices and staff. This means that, in order for KPST to be developed as a centralised institution, a low administrative-cost base must be maintained. Moreover, TAK is responsible for the reconciliation of the quarterly accounts and, after verifying the ID, the contribution data is to be transferred to the KPST. Later on in this report, the collection process will be discussed more in-depth as it has proven to be challenging, comprising heavy implications for the future. Importantly, in 2011, KPST had 587.8 million (€) under its management, 388,483 individual accounts, and 251,510 active contributors.²⁷

²² Where a participant is able to provide certification of total and permanent disability prior to age 65, the balance in his/her KPST account is converted to an annuity (provided sufficient funds have been accumulated, as per the old age pension; alternatively, a lump sum payment is made). Where a participant dies prior to age 65, the balance in his/her account is transferred to one or more beneficiaries.

²³Gubbels, J. Snelbecker, D. and Zezulin, L. (2007). The Kosovo Pension Reform: Achievements and Lessons. Social Protection The World Bank Discussion Paper No. 0707

²⁴The Pension Regulation 2001/35 set a threshold amount of 2000 Euro, above which an annuity must be purchased. In absence of such amount the regulation provides for the payment of a lump sum benefit. For more see Pension Fund of Kosovo, Annual Report of 2011 page 43.

²⁵Agron Krasniqi, Deputy Director, KPST, personal communication, July 2012.

²⁶Law No. 04/L-101 on Pension Funds of Kosovo, available at: <http://www.assembly-kosova.org/common/docs/ligjet/Law%20on%20Pension%20Funds%20of%20Kosovo.pdf>.

²⁷Trust of Pension Savings in Kosovo, Annual Report 2011, page 38 and 39 and Table 29. Available at: http://www.trusti.org/Dokumentet/Shqip/Raportet%20vjetore/Raporti_vjetor_2010.pdf.

Pillar III: Voluntary Schemes

Pillar III comprises of the voluntary, supplementary private pension schemes that can be abolished by employers as a benefit for their employees and by individuals themselves. The schemes are licensed and regulated by the Central Bank of Kosovo (CBK). Currently, there are two types of supplementary funds: the Supplementary Employer Fund, and the Supplementary Individual Fund. Under supplementary collective pension insurance, tax relief for employers as well as employees is foreseen. Additionally, pension insurance can be used as an incentive tool for employees; this can be integrated into the employer bonus, and also considered as a supplement to the employees' salary.

Currently, there is only one private licensed supplementary pension fund, which is at the same time licensed as an asset manager. Slovenian-Kosovar Pension Fund (FONDI) was established in 2006 and is licensed by the CBK. It manages all the activities concerned with supplementary pension fund, such as the collection of contributions/assets in individual accounts, the maintenance and management of individual accounts, the management of the assets, and payments/remuneration of supplementary pensions.²⁸ Each of the voluntary participants has an Individual Account with FONDI, to which contributions are credited. The contributors in FONDI do not seem to encounter high fees compared with countries in the region; rather, it charges entry, exit, and management fees of 3%, 1–2% and 1.5%, respectively (see Table 8). However, contrary to KPST, the contributors in FONDI encounter entry and exit fees, plus a management fee of almost double that of the former.

Table 8: Fees Paid by Participants in Pension System

Country	Entry Fee	Management Fee	Bank Fee	Exit Fee
Kosovo KPST	-	0.65%	-	-
Slovenian-Kosovar Pensional Fund ²⁹	3% of monthly contribution	1.5% of average net amount	-	1%–2% a year of the total amount
Bulgaria - Dovereie - Saglasie - DSK-Rodina - Allianz - ING Bulgaria - CCB-Sila - LukoilGarant-Bulgaria - DZI	Same for all: 5% from each contribution	Same for all: 1% from net assets	No fee	Same for all: Approximately 10 EUR

²⁸ General presentation of FONDI, Available at: http://www.fondipensional.com/english/shkarkime_main_eng.html.

²⁹ Information available at: http://www.fondipensional.com/FAQ_main.html

Macedonia - KB POPF - NPF	Same for all: 8.5% ³⁰ from each contribution	Same for all: 0.05% monthly fee of total net assets	Included in entry fee	Same for all: 9–2.25% ³¹
Croatia - AZ - Erste - Raiffeisen - PBZ/CO	0.7% ²⁰ 0.8% 0.6% 0.8%	1.2% 1.2% 0.95% 1.2%	0.07% 0.08% N/A 0.065%	Same for all: Year 1–0.8% Year 2–0.4% Year 3–0.2% After year 3 no charge

Source: CRPM Policy Study N.5 (2007), KPST Annual Report (2011) and FONDI, Regos, www.fsc.bg

The State of Pensioners in Kosovo: The main gaps and challenges of the system

Although the current pension system has been designed to offer widespread coverage, the reform has not solved the problems associated with inclusion and pension adequacy. Considering its very low rate, the basic pension can merely be considered a social-assistance pension. Moreover, the current basic pension rate, as will be further elaborated on later in the text, does not equal even 30% of the average wage, therefore failing to provide a means to escape old-age poverty. Moreover, given the nature of pension system, failing to regularly contribute and secure a sufficient pension, many individuals risk being excluded from the contribution schemes, thus becoming exposed to old-age poverty and social exclusion. With this noted, below we highlight the main gaps and challenges associated with the current pension system and the possible consequences attached to it.

Deficiencies in Transition: Absence of smooth transition in the process of reforming the pension system

One of the main challenges associated with the pension system in Kosovo is the rough transition to the new system. The transition took place by drawing a clear line between the past and current system; thus, from the solidarity PAYG system, the reform transited to multi-pillar social, state-funded and defined contribution schemes. This was initiated mainly with the aim of avoiding the problems that could arise as a consequence of post-war circumstances.

Notably, the absence of a smooth transition resulted in many drawbacks for both groups of pensioners, especially those who contributed to the previous system. One of the main drawbacks is the failure in terms of properly categorising the pensioners, placing all individuals 65 and more into one category—irrespective of their past employment-status record. In the context of the Yugoslavian system, the former participants of such system were placed in the same category as those individuals who had never worked or participated previously. With that noted, the years of experience and funds contributed to the previous system were fully ignored. As a result, irritations and dissatisfactions of the former participants are evident. The main dissatisfaction with the new system seems to be the universal categorisation, encompassing also the under-compensation.

³⁰This fee includes 1.5% charged by the Agency for Supervision of Fully Funded Pension Insurance, 0.6% for Pension and Disability Insurance Fund of Macedonia, and 0.7% for the National Bank of the Republic of Macedonia.

³¹For less than 6 months: 9%; 6-11 months: 6.75%; 12-17 months: 4.5%; 18-23 months: 2.25%. 24 months – no charge.

Government authorities claim that the lack of available information for past contributions is the main factor making the categorisation of contributors almost impossible; however, although the data on contributions were not complete due to a loss of data during the NATO bombing of Serbia in 1999, Mr. Hasan Berisha³² believes the data from M3 and M4 forms³³ were not lost. Moreover, as the data on years of experience would be easier to obtain, pensioners could at least be categorized on seniority bases.

Besides, only 32,415 of around 130,000 current pensioners have contributed to the previous system. With this in mind, a categorisation based on years of contribution would be sustainable, placing individuals into categories according to every 5–10 years of experience, meaning those with a greater number of years' contributions earn the highest certain percentage of the average wage. However, only in 2009 did a differentiation of the contributors to the old system take place. In 2009, the government introduced an extra 35€ to be paid to individuals who contributed in the last system, but ultimately failed to create a proper categorisation.³⁴ Even with the additional 35€, the pension was considered largely inadequate, and failed to help pensioners cover basic needs.

The Failure to Adopt the Law for State-funded Pensions

Kosovo has established a basic legal framework focused on regulating the pension system; however, it nevertheless failed to approve the law regulating state-funded pensions. There have been many occasions where the draft law has been ready for approval but yet failed to be approved in Parliament; this is a result of political negligence, which in turn has deteriorated the already unsatisfactory poor state of pensioners. The government officials admit the delays in approving the law and identify the financial constraints as the major reason.³⁵ Policy makers should consider a rather more balanced distribution of budget, avoiding over distribution of budget towards one sector (i.e infrastructure), hence providing means for proper budgeting of social issues. Throughout the implementation of the current system, pensioners consider themselves to have been significantly downgraded in both financial and moral aspects.³⁶ Only now has a draft law on state-funded pensions been preceded in Parliament; nonetheless, the dissatisfaction from the pensioners is still evident. According to pensioners' reps, being a systematic law, the current draft law does not include/comprise the most elementary systematic dispositions; it is rather more concerned with procedural issues'.³⁷ Regardless, the draft-law still fails to regulate the issues of pensioners, particularly the contributors of the past system. In particular, the issues, such as the criteria to be classified as contribution payer, the categorisation, pension adequacy, and its harmonisation, all remain unsolved. Contrary to the past system, pensions for the families of pensioners in the case of death, as well as invalidity pensions, are not yet provided for under the current system. Granting such pensions has been

³² Secretary, Association of Kosovo Pensioners, personal communication, July 2012

³³ The M3 and M4 forms included information on contributions of two older groups of contributors while M1 and M2 the two groups of younger contribution payers.

³⁴ Recently, according to a government decision, starting from January 2013, the pension rate of both pensioners with history and non-contributors is foreseen to increase by 40% and 33.3%, respectively. Moreover, for the period from January 2012, pensioners are promised to receive a retroactive increase of 26.45% and 11.1%, respectively. However, in spite of the increase, the disparity between the basic pension rates and minimum/ average wage remains evident.

³⁵ <http://kosova.info/2012/06/te-permiresohet-gjendja-financiare-te-pensionisteve>

³⁶ HasanBerisha, Secretary, Association of Kosovo Pensioners, personal communication, July 2012

³⁷ HasanBerisha, Secretary, Association of Kosovo Pensioners, personal communication, July 2012

foreseen with the new draft-law; however, this is expected to be applicable only from 2016 onward.

Due to the perceived unfairness and unpopularity of the current system and draft law, the pension representatives claim to have raised their voice, expressed concerns, and offered suggestions. However, in turn, they claim to have been faced with excessive negligence. Amongst other factors, significant disapproval can be observed in relation to the imperfect categorisation of pensioners as regulated with a by-law act. Mr. Berisha considers 'a basic/elementary right cannot be regulated by a sub-law act, on the contrary it has to be regulated by the law itself' (personal communication, Prishtina, July 2012).

The members of the opposition political parties claim to have offered several alternatives, although this seems to have not convinced the government.³⁸ According to Rita Hajzeraj, LDK has offered suggestions that could help the government to properly regulate the state of pensioners by adequately and suitably categorising and rewarding them. Moreover, she considers that there is an important factor in our favour: the relatively young average age (24–28); nonetheless, this is a factor that, thus far, has not been utilised to the greatest capacity. Given the inefficient performance of the current system, Vetevëndosje opposition political movement has also offered a strategy for reforming the pension system, which proposes the pension rate to reach 270 euro in five years' time.

Considering the issues raised by the pensioners and experts, even if the law is to be finally approved, one may consider that the law will still fail to regulate/improve the standard of living for pensioners.

Pension Adequacy (of Pillar I)

Owing to the transition to the new system, the solidarity or pay-as-you-go system has been abandoned, fully transferring the heavy financial burden to the state budget. Considering the financial limitations, authorities have considered that, during the first several years, the pension level might need to be set even lower than the consumer basket cost. Ten years after its introduction, the poor elderly population still does not receive an income that can feasibly cover their basic needs due to inadequate pension benefits (Pillar I) and inflation rates.

Regardless of its wide coverage, the basic pension (Pillar I) has been followed with severe criticism. As noted earlier, the pensioner representatives consider the basic pension to be a social rather than a pension benefit due to its very low amount/rate.³⁹ According to an article of Koha Ditore Daily,⁴⁰ for the consumption of normal food in Kosovo, a person needs 3.01€/day or 93€ per month due to soaring prices and persisting inflation. With the current pension (45€/80€), a pensioner is unable to cover the costs of food alone, even if housing and medical costs are already covered. Such a 'pension' is largely insufficient in terms of helping the elderly escape poverty, let alone providing means for recreational⁴¹ participation in activities in the society in which they live; thus, pensioners are left in a miserable state of poverty, living on only 1.5€ each day. As such, pensioners rank well below average in their society. In turn, they are

³⁸ Rita Hajzeraj (Democratic League of Kosovo, LDK), Ahmet Isufi (Alliance for Future of Kosovo, AAK) and Dardan Sejdiu (Self Determination, VV), personal communication, Prishtina, June-July, 2012.

³⁹ Hasan Berisha, Secretary, Association of Kosovo Pensioners, personal communication, July 2012. Moreover, this is also in line with the statements of opposition members Dardan Sejdiu from VV, Rita Hajzeraj from LDK and Ahmet Isufi from AKK.

⁴⁰ 'Pensioneri në Kosovë nuk del as për një muaj'. Available at: <http://www.koha.net/?page=1,13,112256>

⁴¹ Rita Hajzeraj, LDK, personal communication, Prishtina, July 2012.

actually excluded from ordinary living patterns, customs and activities.⁴²Government officials have also acknowledged the inadequacy of the basic pension; however, they consider it to be in line with budget availability.⁴³Nevertheless, members of opposition political parties consider that the pension rate must be set at least at the level of minimum wage so as to be able to help pensioners cover at least their basic needs.⁴⁴

One can easily argue that the past system has been far more favourable for pensioners than the current system.⁴⁵ The pension rate in the previous system amounted to more than 60% of the average wage; while currently it is equivalent to only 21.4% of the average wage, backing up the argument that pensioners under the current system are in a worse-off situation than those under the previous system (see Table 5).

Although the law defines the indexation/harmonization⁴⁶ of the basic pension level in accordance with the cost of living every end of year, this has not been observed. Pension increases have always been done on an ad-hoc basis.⁴⁷Moreover, the paradox is that increases have been evident in years of deflation rather than inflation (see Table 7).Despite all this, however, for many years now, the representatives (organisations) of pensioners have failed to preserve the rights of pensioners or to push forward their interests. In spite of relatively low bargaining power and complete negligence from authorities, one can observe unity and focus towards personal benefits among pensioner organizations. The pensioner parties (PPs) have been successful in gaining parliamentary seats in many post-communist countries, such as those in Serbia⁴⁸ and Slovenia⁴⁹ and have managed to join the government coalition. The Slovenian pensioners' party also had two ministerial portfolios in the government.⁵⁰The Croatian PP⁵¹in 2003 also managed to enter Parliament, and was also successful in exercising influence on government.⁵² According to Mr Hasan Berisha, 'pensioners have tried to apply this model in Kosovo but failed due to having two parties established, that aimed entering parliament mainly for the personal benefits granted'. According to him, as the opposition parties are experiencing difficulties in terms of influencing the government on pension policy, one cannot expect pensioners to do it with relatively low bargaining power.

⁴²Townsend, P. (1979) *Poverty in the United Kingdom*, London, Allen Lane and Penguin Books.

⁴³ Sami Salihu, Director of DAPK, Ministry of Labor and Social Welfare, personal communication, June 2012

⁴⁴ Members of opposition, personal communication, Prishtina, June-July 2012

⁴⁵ This is also in line with opinions of pension representatives and experts of the field

⁴⁶Indexation implies the pension benefit rates are linked to the overall change (increase /decrease) in economic growth, and subsequently, average earnings. By this mechanism countries ensure that pensioners will also benefit from positive economic developments in a society.

⁴⁷ Rita Hajzeraj, LDK, personal communication, July 2012.

⁴⁸ The Party of United Pensioners of Serbia (PUPS).

⁴⁹ The Democratic Party of Pensioners of Slovenia (DeSUS).

⁵⁰Seán Hanley (2010) 'The emergence of pensioners' parties in contemporary Europe'. Chapter 12 in Joerg Chet Tremmel (ed.) *Young Generation Under Pressure? The Financial Situation and the 'Rush Hour' of the Cohorts 1970-1985 in a Generational Comparison*. Berlin: Springer Verlag, 2010, pp. 225-244.

⁵¹ The Croatian Pensioners' Party (HSU)

⁵²Seán Hanley (2010) 'The emergence of pensioners' parties in contemporary Europe'. Chapter 12 in Joerg Chet Tremmel (ed.) *Young Generation Under Pressure? The Financial Situation and the 'Rush Hour' of the Cohorts 1970-1985 in a Generational Comparison*. Berlin: Springer Verlag, 2010, pp. 225-244.

Table 7: Average Consumer Price Index through 2002–2011

Year	Average CPI	Average Consumer Price Change-Inflation	Basic Pension Rate
2003	100.3	1.3	28€
2004	99.2	-1.1	35€
2005	97.9	-1.4	40€
2006	98.5	0.6	40€
2007	102.8	4.4	40€
2008	112.4	9.4	40€
2009	109.7	-2.4	45€
2010	113.5	3.5	45€
2011	121.8	7.3	45€

Source: Statistical Office of Kosovo, Ministry of Labour and Social Welfare

Despite the fact that pensioner parties' have absolutely no access currently in Kosovo politics, pensioners should have a far more organized and manageable influence so as to be able to reach their collective targets. Once in office, pensioners' parties could be able to push forward their interests or extract specific or short-term concessions relating to the financial or institutional support for pensioners.

High Rates of Contributions' Evasion and Risk for Exclusion:

I. Non-Compliance and Low Contribution Level

In spite of the wide coverage yet inadequacy of the basic pension, one of the key issues facing the pension system is the near exclusion of some groups that have never or insufficiently contributed to the system. Such excluded groups include informal workers, 'wait listed' workers, rural residents, and minorities who have never been formally employed, as well as farmers or the self-employed. Non-compliance and a low level of contributions can be considered one of the main factors contributing to this situation. The high incentives for non-compliance—and almost no incentives for compliance and inclusion in the system—due to low wages, low formality (employers operating informally), lack of awareness, and low confidence and trust in the pension system—largely affect the number of contributors. Full compliance and inclusion in the pension system can be observed only for budget users, i.e. civil servants. As such, many social groups risk being exposed to the risk of old-age poverty and social exclusion.

Collecting contributions on a regular basis is vital for the operation of the pension system. That said, contribution evasion seriously harms the proper functioning of defined contribution schemes and their effectiveness. Given that the current working-age population pension is conditional on the pension savings and their return on investment, failure to be included in the system exposes them to the risk of losing social (Pillar II) benefits in the future. Currently, KPST counts only 399,075 contributors⁵³—only slightly higher than in 2011. However, of 388,483 contributor accounts registered with KPST in 2011, only 251,510 have actively contributed.⁵⁴ This is alarming as it accounts for around only 40% of registered contributors. The gap between

⁵³ As per 30 June, 2012. For more see key facts in <http://www.trusti.org/>

⁵⁴ Trust of Pension Savings in Kosovo, Annual Report 2011, page 39. Available at: http://www.trusti.org/Dokumentet/Shqip/Raportet%20vjetore/Raporti_vjetor_2010.pdf

passive and active contributors has been evident since 2006/2007, and highlights the persistent nature of this phenomenon.⁵⁵ Considering that this scheme is fully dependent on contributions, the aforementioned trends suggest that it is unrealistic that such a category of individuals will succeed in terms of accumulating sufficient funds for an adequate pension. Issues concerning compliance and contribution evasion may arise from different causes, such as institutional arrangements, employer and worker causes,⁵⁶ as well as the presence of phenomena/problems such as grey economy and unemployment.

II. Institutional Causes

Considering the level of contributions collected, and the number of contributors compared to the number of employed individuals, one could argue that the collection mechanisms are largely inefficient and with many deficiencies. The deficiencies arise from several sources: firstly—and most importantly—the failure to enforce the law, which yields several consequences. One consequence arising due to the failure to enforce the law is persistent and sizable informality. The existence of informality makes manifest in that individuals active in such activities are not formally registered as employees; hence, their full obligation in terms of paying contributions is concealed. A significant proportion of the population is active in the informal labour market. As a result, many categories of the current (informal) working force risk remaining excluded from DC schemes due to contribution evasion. Secondly, the controlling mechanisms are largely ineffective and too slow.⁵⁷ As KPST has no mechanisms to inspect and enforce the contribution collection, the responsibility falls on TAK. The latter, as the technical collector of the contributions, plays the key role of collecting taxes; thus, not many mechanisms are in place to inspect the firms concerning the pension contributions. However, TAK can ask employers to pay the contributions for their employees via the process of declaring the tax obligations. Or, in the case of observed high annual turnover, on the one hand, and a very low number of employees declared on the other, TAK can impose a policy to stimulate full declaration of employees.⁵⁸ However, many challenges remain, as will be further highlighted below, regarding the causes for contribution-evasion associated with the employer. Despite this, KPST can still do its part by undertaking an intensive awareness campaign, as many individuals are largely uninformed about the system. Moreover, the lines of communication between the TAK and KPST seem to be unproductive, as many TAK duties concerning contributions are performed very slowly, thus resulting in considerable policy deficits. Nevertheless, KPST must pressure/insist TAK to be more cautious in the process of declaring taxes and contributions by employees.

III. Causes Lying with Employers and Employees

There appear to be a high number of employees who do not fulfil their pension contributory duties. A large percentage of private-sector employers—with the exception of foreign companies and a small number of successful local companies—often decide to pay contributions in accordance with the minimum legally-allowed wage; thus, as a consequence of this partial informality, the individuals will be left with insufficient pension benefits during retirement owing to insufficient funds accumulated during the working age.

⁵⁵ Ibid.

⁵⁶ Strban, G. (2007). 'Contribution collection system and possible measures to improve their effectiveness', Council of European Commission CARDS, April 2007.

⁵⁷ This has also been reported by Strban, G. (2007). 'Contribution collection system and possible measures to improve their effectiveness', Council of European Commission CARDS, April 2007.

⁵⁸ As it is hardly possible to operate with such a low number of employees.

A cause that lies with both employers and employees is the difficult financial situation in which they stand currently.⁵⁹ In general, both employers and employees prefer higher current disposable income instead of having to set aside a part of their income into the pension system, which is generally believed to be unfair and insufficient. Thus, many employers who lack financial resources prefer not to pay taxes, let alone contributions for their employees.

In specific cases, the employers may pay net salaries but do not declare any of the pension obligations with the tax office, which is one of the worst contribution evasions. This is also the case with many financially wealthy employers, who do not pay contributions only to reduce their expenses.

According to an EU report, the survey results indicate that the employers turn out to be the main actors responsible for not paying contributions in Kosovo.⁶⁰ Considering the wages in the market, employees earn rather low levels of wages, and as such are more prone to colluding with the employer and remaining informal. This means employees would accept to earn the full wage (bruto) rather than reduce its amount by paying taxes and contributions. On the other hand, even if they are willing to pay, private-sector employees lack the bargaining power to push their employers to pay their contributions as they could face the threat of losing their job. KPST officials confirm the above cases as having been evident.⁶¹ Considering the large-scale unemployment and difficulties in finding a job, the opportunity to report such cases to the authorities seems almost impossible. Thus, the vast majority hesitate to undertake any such action. Also, KPST officials claim that no cases have yet been reported to the police mainly due to fear of job loss.

In these cases, KPST informs TAK and accordingly suggests that during the inspection of such firms, the names of the employees, for the aforementioned reasons, must remain anonymous. Yet, this safeguard has not encouraged employees to come forward. This implies that either TAK has failed to undertake such inspections, or the employers have managed to solve the problem under-the-table. Another factor that contributes to a low number of contributors in KPST is the existence of the minimum guaranteed pension, which provides comfort and incentives for many individuals'—especially high earners—to exclude themselves from the system. Mainly due to the aim to receive a higher net salary, individuals avoid paying contributions given that they will be entitled to the basic pension in the future. However, a lack of trust in the system and low pension benefit expectations could also add to the situation. The performance of KPST over the last few years and the low number of contributors support this opinion.

Another problem/challenge associated with the system is the failure and/or evasion of paying contributions for self-employed, rural workers, and traditionally excluded groups. Groups that operate mainly informally, thus have a high risk of exclusion from the pension system, are commonly the self-employed, rural workers and farmers. These groups are more prone to not

⁵⁹ This has also been reported as one of the main reasons by the study on Strban, G. (2007). 'Contribution collection system and possible measures to improve their effectiveness', Council of European Commission, page 30. Drawing from answers of questionnaire in Kosovo, the study reports that 'in the territory of Kosovo, lack of resources is definitely one of the reasons (although not the only one) for relatively low contribution collection.

⁶⁰Grega Strban (2007) 'Contribution collection system and possible measures to improve their effectiveness', Council of European Commission CARDS, April 2007, page 33.

⁶¹In such cases, on one hand, the report sent by KPST reports no contributions to have been paid. While on the other hand, every month the amount of contributions has been deducted by their wage. This has had many employees reach KPST offices. After explaining that it is the employer who has to declare their contributions, they have been suggested to either ask from their employer to pay or inform the police.

contribute for several reasons. The low or insufficient level of income from their activity leaves hardly any possibilities for paying pension contributions. An important factor is also the lack of information and awareness on the benefits of being included in the pension systems. This is mainly due to the negligence of responsible authorities or the lack of access to system's institutions. Other reasons that could further add to non-contribution are also the lack of trust in the state and the system, and the perceived 'high cost of inclusion' by those who can afford the involvement. Thus, a long-term direct consequence of this is the risk of exclusion from defined contribution schemes, which, in turn, means reliance on social pension—the so-called basic pension—which has proved to be highly inadequate.

Table 5: Pension payments (in 1989 and 1998) and Contribution Based Pension—Pillar I

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

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

Women are also a group that have a high risk of exclusion from the pension system. Kosovo risks encountering gender problems in the future when it comes to the coverage of such a group from the contribution schemes benefits. According to the Statistical Office of Kosovo (SOK), only 28.8% of women in 2009 were active in the workforce, whilst only 13% of women able to work are actually employed.⁶² According to KPST annual report, only 28.3% of contributors in 2011 were females.⁶³ Moreover, over the years, the number of female contributors has gone up by only a small percentage, i.e. from 27% in 2007 to 28.3% in 2011 (see Table 10).

Table 10: The percentage of woman as active contributors in the KPST during recent years

Year	Women as active contributors in KPST (%) through years
2007	26.9%
2008	27.2%
2009	27.5%
2010	27.9%
2011	28.3%

Source: KPST Annual Report, 2011

Given these figures, the majority of women in the work force are unemployed, and therefore risk being excluded from DC schemes, having to rely only on the basic pension. This can be mainly a result of several factors: firstly, many women do not participate in any economic activity due to being principally concerned with family responsibilities; secondly, many women (but also males) do not search for job opportunities due to a lack of trust in authorities and general belief of no

⁶² Statistical Office of Kosovo, The Workforce Survey, 2009, page 17

⁶³KPST, Annual Report, 2011, page 41. Available at: http://www.trusti.org/Dokumentet/Shqip/Raportet%20vjetore/Raporti_vjetor_2011.pdf

employment opportunities.⁶⁴ As such, job creation—and especially opportunities being open to both males and females similarly—will contribute towards higher female participation in the labour market, and thus the pension system.

In all countries of the region, there are groups that are very rarely included in any type of the pension system. The most typically excluded groups are the ethnic communities, such as Roma, Egyptian, and Ashkali. Some of the main reasons for the exclusion of this group are the customary factors, including the lack of awareness, the lack of trust in the state and the system, and the tendencies of non-involvement with any of the state issues, such as education, health, and other sectors. However, a major reason is also the lack of employment opportunities open to them.

A group at risk for total exclusion from the pension system is invalids who fail to meet the invalidity criteria. In the case of incapability due to injuries at work, such individuals are, at the same time, subject to economic deprivation as the state does not grant a pension through which they would manage to cover their financial needs. That noted, until they reach the retirement age, they will have to rely on other financial means such as support from family. Moreover, upon retirement, they will have to rely on only the basic pension as they are unable to work in order to accumulate contributions. Only with the new draft law on pensions, which are financed by the state budget, is this category included in the pension schemes; although this will not be applicable until 2016.

Persisting High-level Unemployment and Informality

Given the nature of the pension system, social peace is at risk and many individuals risk losing benefits deriving from the defined contribution schemes due to the persistently high levels of unemployment and informality. On the one hand, the steady employment rates lead to modest increases in the number of the pension contributors; on the other hand, a lack of formal jobs and the high rate of informality have added to an unsatisfactory increase in the number of pension contributors.

Based on the preliminary finding of Kosovo's 2012 census, of 1.8 million residents, 64% (around 1.52 million residents) are working-age population. According to the Ministry of Labour, only 500,000 of the total working-age population are currently employed. With this noted, only one-third of the working-age population are employed, although considering the large informality, the number of employed individuals must be higher.

A high level of unemployment is a persisting phenomenon in Kosovo with alarming levels of long-term unemployment. The number of registered unemployed individuals has remained more or less on the same level, slightly falling during the last three years.⁶⁵ According to MLSW, around 93.8% of the overall number of unemployed in 2011 has been registered for more than 12 months; 81.7% have been registered as unemployed for more than 36 months, therefore implying long-term unemployment remains a central problem in the labour market. Given that the government still fails to create long-term jobs, most individuals may end up being in the same situation for many of the coming years. The persisting high levels of unemployment and informality in Kosovo may, in turn, induce long-term consequences for the next generations of pensioners—provided that no timely solutions are found. Therefore, only sufficient job creation and reduction of informality may improve the functionality of the pension system.

⁶⁴Statistical Office of Kosovo, The Workforce Survey, 2009

⁶⁵Ministry of Labour and Social Welfare (2011). 'Promoting Employment', Performance Report. Available at: <http://mpms.rks-gov.net/Portals/0/Librat/06-2011%20Raport%20i%20Performances-Shqip%202011.pdf>.

Low Rate of Contributions—Both from Employer and Employee Side (5%+5%)

The goal of Pillar II is to provide increased benefits for pensioners. Thus, the participants accumulated funds (assets) are invested through international assets managers. This means the level of their pension is dependent mainly on the funds accumulated throughout the working life. As was explained previously, both employer and employees (including the self-employed) are obliged to contribute at least 5% of the monthly wage to the pension savings. Taking into consideration many factors that influence the contributions and the rates of future pensions, one could argue that current workers risk ending up in an unfavourable situation in the future. Kosovo has the smallest contribution rate in the region, as all other countries rates amount from 16% to more than 20% (see Table 9, column 6). Considering the average wage (currently 374€), even if assuming that contributions are paid on regular basis and taking into account the KPST's investment policy and the investment performance so far, one cannot expect a satisfactory pension when retired. The picture seems to be even worse for most of those who will reach their pensionable age in the near future (the next 10 or 15 years), as the accumulated funds with KPST will be largely insufficient to provide a pension for the years in retirement.

In order for each pensioner to be able to earn a decent pension, authorities can consider undertaking any of the options below. To ensure pensioners receive a sufficient pension when retired, KPST can differentiate contributors by age. Thus, the contributions of those approaching retirement age could be invested in more conservative instruments so as to avoid negative investment returns. Alternatively, government authorities can consider setting a floor-pension—which together with the basic pension—would make a pension at least equivalent to average wage upon retirement. Another possibility could be establishing a special solidarity fund that would complement the pension of those who ultimately receive a low, insufficient pension.⁶⁶ This, at the same time, provides the means to smooth the transition for past contributors. The fund could be funded by the following: a) the government via different means of funding (such as 1% of duty tax on luxury goods), or b) a suggestion of the experts has been introducing the 3%+3% contributions in addition to that of Pillar II—supplementing the pensions of both Pillar I and Pillar II. However, introducing an extra 3%+3% contribution rate holds the risk of further stimulation for the growth of informality. In order to avoid this happening, the authorities must intensively work on general awareness—specifically in regard to its reasoning, benefits, and the threats of remaining informal in the long-term.

Another possibility is the regulated liberalisation of the pension-funds' market; thus, the pension funds could be conditioned for providing a guaranteed percentage of return.⁶⁷ In cases of failure to achieve the required return, the funds would finance this from their own finances; this would limit the extent of their engagement in risky investments, thus reducing it to a lower acceptable/safer percentage. This, however, can also be associated with the risk of preventing investors from entering the market. Application of the aforementioned case in practice would require changes in the current legislation, and specifically changes to article no.9 of the Law on Pension Funds on Kosovo⁶⁸ concerning the investment strategy of pension funds.

⁶⁶ This is in line also with suggestions of interviewed KPST and VV officials/experts, who argued introducing contribution rates of at least 3%+3% in pillar I would contribute to better pension rates in the future.

⁶⁷ This been suggested also by the experts from Vetëvendosje.

⁶⁸For more see Law No. 04/L-101 on Pension Funds Of Kosovo, Article 9 Investment by the Kosovo Pensions Savings Trust. Available at: <http://www.bqk-kos.org/repository/docs/2012/Law%20on%20Pension%20Funds.pdf>

The Monopolized Market: The (Im)Possibility of Choosing an Investment Portfolio?

Considering the issue of pension fund's international investments, the net return of the funds of KPST is not as satisfactory as it was in the early years. The heavy losses that already overcome the relatively high positive returns have not yet been recovered. Until 2007, KPST has invested the funds with a more conservative strategy—mainly in public debt—such as government bonds, and has thus gained a higher than 20% return on investment. 'However, in 2007, the Board considered that the demographics allow us for more risky investments. As a result, aiming at a higher return, it has switched to investing a higher percentage on equities'.⁶⁹ Followed by the global financial crises, losses were incurred on the amount of return already accumulated, plus another 30% in the original investment. With this noted, nevertheless, 'the accumulated funds have been lessened by around 150,000€'.⁷⁰ Based on the assumptions that pension funds manage long-term funds, pension funds undertake riskier investments aiming at higher returns as the time span is longer; hence, chances for recurring the losses are higher.⁷¹ Nevertheless, following this assumption, contributors are often exposed to excessive risks, irrespective of their will. Moreover, as in the current system, individuals are obliged to contribute a certain percentage but are not protected from risk of losses;⁷² therefore, the risk is fully transferred to them. As the risk falls solely on the shoulders of the contributor, they must be given choices (portfolios) wherein money would be placed according to their preferences.⁷³ This will allow younger, less risk-averse individuals to choose to invest their funds in more risky investment instruments, and vice versa, for risk-averse individuals. In order to achieve this, however, KPST must be permitted to start offering portfolios, and to fully inform the general public about the overall dealings and its importance.

Another option would be giving individuals the opportunity to choose between different operators, whilst taking into consideration their investment strategies, returns, and portfolios if available. This, in turn, could stimulate competition, which could affect the number of contributors, as operators could invest more in marketing and pressure TAK to supervise the private sector and fight informality more aggressively. The former requires the liberalisation of the market to enable new entrants to compete with KPST.

However, KPST officials are not of the same opinion. Firstly, Mr. Agron Krasniqi argues that introducing competition to KPST would prompt the privatization of the sector. He considers that the private pension fund's main objective is profit; thus, costly and not in favour of contributors; the performance and profits of funds in Croatia is an example that supports this.⁷⁴ Secondly, he argues this will cause an increase in the number of managers, and thus the relatively high wages paid; this will cause financial redundancy, bared by contributors through the introduction of different fees. Thirdly, as these companies will compete with each other, each will try to earn the highest return on investment in order to attract more contributors. This will stimulate investments into more fragile instruments, which in turn pose a higher risk to the

⁶⁹ Agron Krasniqi, Vice-director, KPST, personal communication, Prishtina, July 2012.

⁷⁰ Dardan Sejdiu, VV, personal communication, Prishtina, June 2012.

⁷¹ Agron Krasniqi, Vice-director, Trust, personal communication, Prishtina, July 2012.

⁷² The pension payable at retirement, among other factors, will depend on investment performance.

⁷³ This is in line with suggestions of Dardan Sejdiu, (VV) the expert of the field, reflected in the strategy for reforming the pension system in Kosovo.

⁷⁴ According to Mr. Krasniqi, Croatia actually has 4 pension funds, the overall return on investment for the 2011 has been -2% while the pension funds have gained a profit of 25€ million.

contributors.⁷⁵ However, prevention of pension funds from investing heavily in fragile/risky instruments could be achieved if government authorities are to impose a minimum guaranteed return by law; which at the same time could negatively influence their entry decision.

Another argument is the lack of interest of individuals in choosing one operator against the other, as is the case with Sweden, Croatia, and Macedonia.⁷⁶ This could be the case for Kosovo as a result of the lack of information and awareness; however, due to the very low pension rates, individuals might be interested in deciding where their funds are being invested, aiming at a better pension in the future.

To note, ultimately, Mr. Krasniqi argues that the new funds will not be able to achieve a better performance than KPST. For instance, Croatia and Macedonia are required to invest at least 50% of their funds in state bonds; accordingly, performance has not been much different from one to the other; as a result, there is not much choice given to contributors. However, while it is relevant for the cases of Croatia and Macedonia, this will not necessarily be applicable for Kosovo as the largest majority of investment is concentrated abroad.⁷⁷ That said, funds in Kosovo will have opportunities to invest in both conservative and more risky instruments. Offering portfolios to contributors makes more sense, as some funds may be more vulnerable in terms of investing in conservative stocks, whilst others are concerned with more risky investments.

Investment Restrictions: An Issue that Needs Consideration

Contrary to some countries in the region that are required by law to invest up to 80% of the pension fund assets domestically, Kosovo is an exception (see Table 6). According to the law, KPST can invest only a certain percentage of the assets domestically—despite the immense need for investments.

Experts, opposition parties' members, and media have continuously argued for a larger percentage of pension fund assets to be invested in the internal market in Kosovo. With the new legislation in place, KPST is permitted to invest 30% of its assets in government bonds (as opposed to 5% in adherence to the previous law).⁷⁸ However, experts argue that the option to invest in government bonds is based on the assumption that there will be constant economic growth in the future. Thus, according to experts, the assets should be invested in strategic instruments that are expected to yield returns rather than in bonds/securities that are oriented towards capital investments and wages, upon which the pension fund cannot estimate a return. Besides, there is a serious need to finance projects, such as industrial projects, start-up business, agro finance, and infrastructure finance, all of which are currently largely unavailable.⁷⁹ Moreover, it has been suggested that the funds should at least be domestically invested in the assets of KEK, PTK, and Trepca, which is a rather calculated risk.⁸⁰ However, KPST argues that, according to the law, the Board is not permitted to purchase such domestic public assets as the

⁷⁵ Agron Krasniqi, Vice-director, KPST, personal communication, Prishtina, July 2012.

⁷⁶ Ibid.

⁷⁷ See table 6 for investment requirements in these countries.

⁷⁸ See table 2

⁷⁹ Field experts, personal communication, Prishtina, June/July 2012.

⁸⁰ Dardan Sejdiu, VV, personal communication, Prishtina, June 2012.

value of the shares cannot be valued realistically.⁸¹ Given that PTK is currently valued at 300 million (€), purchasing such assets seems to be impossible for KPST, although such argument of the KPST officials could not be taken for granted.

Country	Investment Requirements	Restrictions
Kosovo	Only 30% of total assets can be domestically invested	There are no limits on investments abroad
Croatia	A min of 50% of assets must be invested in securities issued domestically	Only 20% of total assets can be invested in foreign assets ⁸²
Macedonia	Up to 80% of assets can be invested domestically with restrictions on the value of value of investments in certain instruments	No more than 20% of the value of the assets of the Pension Fund may be invested in assets issued by a foreign issuer outside the Republic of Macedonia.
Bulgaria	At least 50% must be invested in government securities	Only 15% of total assets can be invested abroad

Source: Regos, Pension Funds Online (Bulgaria's country profile), KPSTi, Macedonia Law No. 29/2002

Table 9: Pension systems in Kosovo, Albania, Macedonia and Croatia

Country	Pillar I	Pillar II	Pillar III	Contribution Rate PAYG	Contribution Rate Pillar II	Reform
Kosovo	State funded Basic Pension Scheme	Mandatory DC Scheme	Voluntary DC Scheme	-	10% (5%+5%)	Implemented 2003
Albania	Mandatory Pay-as-you-go Scheme	Mandatory DC Scheme	Voluntary DC scheme	21.6%-23%	8.8% + 12.8%	Recently introduced Pillar II
Macedonia	Mandatory Pay-as-you-go Scheme	Mandatory Private Management DC Scheme	Voluntary Defined Contribution Scheme	9.75%	5.25%	Reform initiated in 1997 and started to be implemented in 2006
Croatia	Mandatory Pay-as-you-go Scheme	Mandatory Private Management DC Scheme*	Voluntary Defined Contribution Scheme	15%	5%	*Implemented in 2002

Source: V. Sonje (2011), CRPM (P.S no 5, 2007), KPSTi, Regos, www.mapas.gov.mk

POLICY RECOMMENDATIONS

- a. Government authorities should consider introducing a minimum income guarantee in retirement, which is linked to increases in national average earnings; this would help to avoid reliance on only means-tested benefits upon retirement.
- b. Those who are able to save should be encouraged to do so and contribute via affordable and secure third-pillar pensions, in exchange for tax relief and other incentives. Also, a

⁸¹ Personal communication, Prishtina, July 2012. As it is the case with PTK, the 40% of its assets are currently being valued at 300 million euro, however he argues this is not a real value assessment and one cannot value it in real terms.

⁸² However, now that Croatia is a member of EU there won't be any restrictions.

means must be found to stimulate paying contributions on the full wage and to avoid under-declarations. Special attention must be directed towards groups at risk of exclusion in the future in order to avoid their further exclusion from the system.

- c. The basic pension rate must be set at the level of minimum wage or at least at the rate of 50–60% of the average wage; this would enable pensioners to cover their basic needs—even if they fail to secure an adequate pension from KPST. However, this requires sufficient financial means so as to ensure its sustainability and wide coverage. As providing these pensions solely from the state budget would result in the overburden of the budget, establishing a special solidarity fund could be considered. The fund can be financed through either introducing an additional contribution rate (3%+3%, as suggested by experts) to Pillar II, or otherwise through different means of funding, such as with a certain percentage, i.e. 1% of tax collected from luxury goods.
- d. In order to avoid the discrimination of past contributors, a categorisation based on years of experience and contributions must be introduced. If authorities are to insist that the data necessary to complete categorisation for the pension contributors of the past system are not available, further differentiation of pension amounts between current beneficiaries should be done using educational level/background as a proxy for former salary or the work experience (years of experience).
- e. Considering the investment policy of KPST, the investment performance so far and the contribution rate, one can argue that many individuals risk ending up in an unfavourable situation. Important factors, such as under-declaration, irregular mode of contributions, and low awareness, for example, further add to the already poor state of contributors. Government authorities should consider the most effective means by which a promising pension can be secured by future pensioners. One of the options is to consider raising the contribution rate in order to provide a means for such individuals to contribute sufficiently for an adequate pension when retired. This requires an estimation of the necessary rate of increase. However, this must be followed by an intensive awareness campaign in order to avoid negative reactions from public. The employers and employees must be able to understand fully the decision so as to prevent the potential side effects of the further spread of contribution evasion. Another option is to establish a special solidarity fund that would complement the pension of those who ultimately receive below-minimum wage pension.
- f. As the contributors bear the entire risk for their funds invested by KPST, they must be given choices (portfolios) wherein their money is placed in accordance with their preferences. This will allow the younger, less risk-averse individuals to choose to invest their funds in more risky investment instruments, and vice versa. In order to achieve this, KPST must be permitted to start offering portfolios, and to fully inform the general public about the overall procedures and their importance.
- g. Another option would be to give individuals the opportunity to choose between different operators, taking into account their investment strategies, returns, and portfolios if available. This, in turn, could stimulate competition, which would affect the number of contributors, as the operators would invest more in marketing and pressure TAK to supervise the private sector and fight informality more aggressively. The former requires the liberalisation of the market so that new entrants can compete with KPST, which subsequently requires a change in the legislation.
- h. A large part of responsibility for the low contribution levels fall on TAK due to inefficiency in terms of collecting pension contributions. More innovative and effective ways of collecting pension contributions should be introduced to improve contribution collection and compliance.

- i. The mechanisms to make the second and third pillars fully operational are not well developed, and therefore are not well devised. Public awareness concerning the pension system and the importance of participation in the system are largely nonexistent. There is, in general, a very low level of public information and awareness among all private-sector institutions. KPST, TAK, and other relevant ministries (as well as other government bodies) should prepare, organise and execute public awareness and public information campaigns. They have to generally be more open to the public, including in terms of delivering information (which is one of their missions) and advising, protecting, and providing quality services—both to pension beneficiaries and contribution payers. In addition, special attention must be directed towards low-income groups such as farmers, rural workers, and women in order to increase their awareness, and to provide space for their full information.
- j. Granting work disability and family pension status, foreseen to be enforced only from 2016, must be considered for implementation at an earlier date—possibly when the law is approved in Parliament.

An assessment of potential sectors, fields, and projects in need of the investment of KPST funds, and their potential for offering positive return, must be conducted. As soon as this is completed, the government must then devise and adopt a legal framework to enable larger proportions of KPST funds to be invested domestically. Additionally, this will help to avoid the investment of funds in wages and capital investments (with only short-term effects).

POLICY REPORTS

Policy Reports are lengthy papers which provide a tool/forum for the thorough and systematic analysis of important policy issues, designed to offer well informed scientific and policy-based solutions for significant public policy problems. In general, Policy Reports aim to present value-oriented arguments, propose specific solutions in public policy – whereby influencing the policy debate on a particular issue – through the use of evidence as a means to push forward the comprehensive and consistent arguments of our organization. In particular, they identify key policy issues through reliable methodology which helps explore the implications on the design/structure of a policy. Policy Reports are very analytical in nature; hence, they not only offer facts or provide a description of events but also evaluate policies to develop questions for analysis, to provide arguments in response to certain policy implications and to offer policy choices/solutions in a more comprehensive perspective. Policy Reports serve as a tool for influencing decision-making and calling to action the concerned groups/stakeholders.