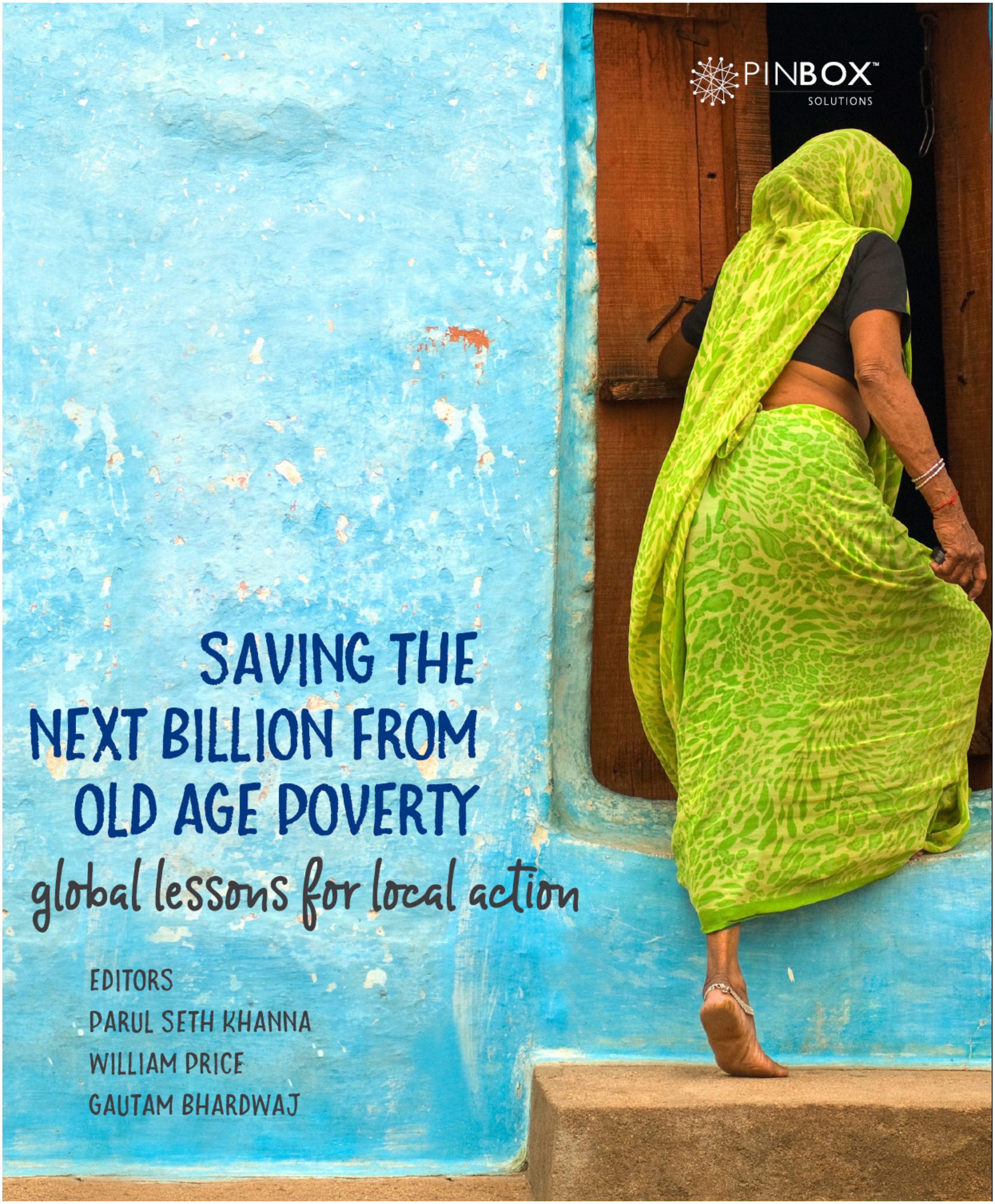

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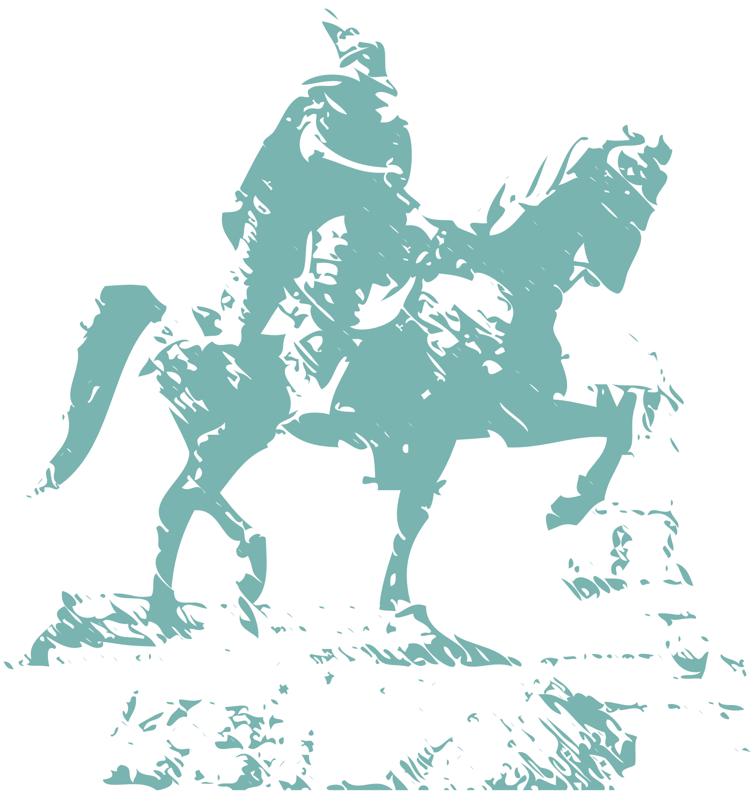
12
PENSION REFORMS AND VOLUNTARY COVERAGE EXPANSION IN ALBANIA

ASTRIT HADO
DIRECTOR GENERAL OF SOCIAL INSURANCE INSTITUTE (SII) OF ALBANIA

JOHN ASHCROFT
JA PENSION CONSULTING



INTRODUCTION

This chapter provides an example of how the development of a system of voluntary private pensions (Pillar 3) has built upon a reform to the system of state pensions (Pillar 0 and 1) to improve the sustainability of the system[1] and to benefit the poorest in society. Establishing and expanding a voluntary pensions system has proved far from easy in a country that has no prior experience of such saving, together with a lack of trust in financial institutions and limited disposable income. Central to this chapter, therefore, is a project to try and boost coverage of voluntary pensions. This case study illustrates the actions that can be taken to help increase coverage, the importance of Pillar 1 and tax incentive alignment, and the inherent constraints and limitations of relying on voluntary pension saving. It also indicates some future directions for further system development – bearing in mind that the potential of bringing together the pension coverage and financial inclusion agendas has not yet been realized.

Putting in place the foundations for a more stable and diversified pension system, as outlined in this case study, can be an essential pre-condition to moving to the next phase of leveraging the potential synergies between pension coverage and financial inclusion. Pushing too far too fast before the pension system was more stable would have been risky – an important message for policy makers seeking to design the most effective reform path for their country.

BACKGROUND TO ALBANIA

Albania, in Eastern Europe, had a communist government prior to 1991 and since then has been a democracy. It is a European Union (EU) pre-accession country. It has 4.2 million citizens, however, with substantial outward migration over the last 20 years, there are 2.82 million persons currently living in Albania[2]. The average age of the population is 35.3 years. Life expectancy at birth for females is 79.7 and for males is 76.1 according to the Albanian Institute of Statistics (INSTAT). The total fertility rate is 1.5 children born per woman. The population at or above retirement age is 15.5% of the total of resident population and is expected to reach 35% in 2080 (INSTAT, 2015).

[1] The terminology of 'Pillars' relates to the World Bank terminology where a Zero pillar is a basic poverty alleviating payment financed from the government budget and sometime called a Social Pension, Pillar 1 is a state contributory pension, Pillar 2 is a mandatory privately invested contributory element, Pillar 3 is a voluntary privately invested contributory pension and Pillar 4 combines alternative forms of providing retirement income such as (shorter-term) savings, housing, and other assets (see Holzmann and Hinz 2005). Other terminology exists, for example with a first pillar relating to state provision, second pillar relating to employer based provision and a third pillar being individual provision.

[2] 2011 Census.

GDP per capita is USD 11,900 (at purchasing power parity) with a substantial balance of trade deficit (imports are 2x of exports). Unemployment in March 2017 was estimated at just over 4.5%. There is a large informal economy and substantial rural poverty. The annual inflation rate (CPI) was 2% in June 2017, having fluctuated 0.2-2.1% over the previous 2 years. The Bank of Albania benchmark interest rate reduced from 2% to 1.25% during 2016. The capital market is at a relatively early stage of development. Investors can put money into bank deposits, fixed term investments and government bonds, and have access to international investments (principally in the Euro area) via investment funds. There is scope for the capital market to develop further, but there are sufficient instruments to allow members to put their money into products that will yield a positive real rate of return.

INITIAL CONDITIONS AND **PENSION REFORM CONTEXT**

Since 2009, Albania has had a two pillar pension system. This includes a long-standing contributory (Pillar 1) pension system, which started in 1947. This first pillar is operated on a pay-as-you-go (PAYGO) basis and is administered by the Social Insurance Institute. Pension benefits under this pillar are determined by the years of insurance contribution, average wage during the beneficiary's working career and an eligible social pension. Albania also has a newly created system of voluntary, funded pensions (pillar 3) using defined contribution individual accounts, offered either to individuals directly or to employees through their employer. This voluntary system is managed by three pension management companies[3], and supervised by the Albanian Financial Supervisory Authority (AFSA).

PILLAR 1 PENSIONS

A December 2006 World Bank policy note concluded with the following findings:

- The level of benefits and the coverage rate for the population at risk would be at low levels in the future, implying inadequate coverage of the elderly in the long run, arising from the low number of working age individuals actively making contributions, so that 40% of the elderly would be left without access to the pension system;
- The system did not provide sufficient incentives to participate, because the maximum pension was limited to twice the minimum pension even though the maximum wage was five times the minimum wage;
- Even though the population was young, contributions in respect of pensions were at a very high level (29.9%), of which 71.2% were paid by the employer. High contribution rates provide disincentives to formalisation of the labour force. In July 2009, the pension contributions level decreased to 24.5%;

[3] Raiffeisen Invest, Sigal-Life Uniqa Group Austria and Credins Invest.

- There were disincentives in the benefit formula for people to declare their full wages or to work throughout their working age; high evasion and the declaration of income lower than the real income resulted in a reduced contribution base;
- There was an increasing number of the current pension beneficiaries, most receiving full pensions;
- There was a lack of benefits in the long term for those who did not pay contributions. Only about 46% of the current workers paid contributions; half of them were from the rural areas, and their contributions were nominal, not substantial;
- There would be an increasingly sharp decline in the maximum benefit stemming from linking of the maximum pension to inflation;
- There was relative over-generosity with respect to rural workers and pensioners; and
- The system was in deficit, even though 85% of the contributions with respect to farmers' pensions were subsidised by the State budget."

By 2012 it had, therefore, become clear that the Pillar 1 pension system was in urgent need of reform. The dependency ratio in 2012 was 1.18 contributors for each pensioner. The deficit of the scheme was very high with the likelihood of it increasing further in short and long term.

VOLUNTARY PENSIONS

The Albanian voluntary pension system, created by Law number 10197, dated 10 December 2009, comprises three pension funds, each of which are managed by a pension management company (PMC). PMCs are required to be subsidiaries of other financial institutions licensed in Albania. For the first few years, the Albanian voluntary pension system grew fairly slowly and had, by 2014, gained a little under 10,000 members and around USD 5 million in assets. The system has grown more rapidly thereafter. By September 2016, coverage stood at 15,957 members (54% of whom are females) while assets under management (AUM) had grown by nearly 80%, to USD 9.25 million.

Individuals could either join on their own account or be enrolled by their employer through a 'professional pension fund'. By September 2016, 106 public and private sector employers were offering this option. Individual accounts were held under the custody of licensed pension depositories and pension savings were administered and invested by PMCs. Given the small size of pension assets, investments have thus far comprised only Albanian Government bonds and bank deposits.

The voluntary pension system is based on sound governance and a strong risk management framework for pension management companies. The custodian depositories use modern technology that enables the use of the national ID system. The scalable IT-based pension architecture is fully capable of servicing a large proportion of the population. The legislation has also been 'future-proofed' by harmonising it with the EU pension directive.

The slow growth of the voluntary pension system during its first five years was partly due to low employer and employee awareness, trust, and serious obstacles with claiming tax relief incentives. The more important reason for the initial slow growth of the voluntary pension system was the existence of the Pillar 1 system. Employers who were under-declaring employees or salaries for contributions to Pillar 1, were reluctant to participate in Pillar 3, as voluntary contributions to Pillar 3 could draw attention to non-compliance under Pillar 1. Hence, a reform to strengthen Pillar 1 compliance became a pre-requisite for expanding Pillar 3 coverage.

Without significant scale and a modest asset base, the voluntary system suffered from both high charges and low net returns that were only a little better than those delivered by bank deposits. However, with regulatory caps, the level of fees and charges in the initial years were lower than the fees achieved through similar reforms across Latin America, Europe and Central Asia (Price and Rudolph, 2013). Given the low returns available, the continuing involvement of sponsors of pension management companies in loss-making enterprises could not be guaranteed. After a review of the system in 2014, the World Bank and the Albanian Financial Services Authority (AFSA) concluded that low coverage was the biggest risk to the system in terms of delivering the outcomes that would be needed to ensure a decent old-age income for the people of Albania (Price, 2014).

THE REFORM PROJECT **AIMS AND ACTIONS**

PILLAR 1 PENSIONS

Having recognised the fundamental challenges in the Pillar 1 system, the Social Security Institute, with support from the World Bank, embarked on a project to re-design the system and improve the prevailing system parameters. This reform would consolidate the contributory principle of the system, and, to some extent, reduce its high redistribution rate. It would do this by providing more incentives for individuals to join and be part of the social insurance system, as well as to improve their contributions by declaring their real wages. This was also expected to reduce the deficit of the pension scheme. The implementation of the Pillar 1 Reform commenced in January 2015 and comprised the following key elements:

1. Improving the current system parameters,
2. Revising pension arrangements for special groups of workers, and
3. Changing the retirement age.

Starting with the modification of parameters, the following changes were proposed, and in due course, enacted:

a. The pension formula was changed to P = Ba + S, where ‘P’ is the amount of the monthly pension and ‘Ba’ is the basic amount, calculated as a product of the social pension and individual years of insurance, divided by the necessary number of insured years defined in the law. In 2016, the necessary insured years stood at 35 years and eight months. These would increase by four months every year till they reached 40 years. 'S' is a supplement calculated at 1% of the average indexed wage over the entire career for every insurance year.

b. Indexation of pensions was limited to the inflation rate.

c. The administrative maximum pension ceased to be the pension ceiling.

d. The minimum contributory wage was unified with the official minimum wage, with the maximum contributory wage indexed to average wage increases.

e. The social insurance period was increased from 35 to 40 years, in phases, through 2025.

f. The retirement age for women would gradually increase by two months per year, to reach age 63 by 2032.

g. From the year 2032, the retirement age for men would be increased by one month per year, while for women it would continue to be increased by two months per year. Thus, the retirement age for both men and women was intended to be 67 years by 2056.

h. For women, privileges were eliminated with regard to the equivalent insurance periods without paying contributions by recognising the period of university studies as a period of insurance.

i. The retirement age was to be increased by five years for mothers with many children as well as for the widows who benefit from survivors' pensions, with the retirement age for these categories fixed at 55 years.

j. The pension calculation and eligibility criteria for rural and urban pensioners was harmonised.

k. Actions were taken to discourage early retirement and to encourage postponed retirement by providing 0.5% of monthly pension as a bonus for every deferred month.

l. The eligibility criteria for the invalidity pension linked to work invalidity were strengthened, by requiring that the person must have made at least one year of insurance contributions within the previous five years.

m. All individuals who did not qualify for a contributory pension were to be entitled to a means-tested, State funded social pension. This social pension would be provided to those aged over 70 years and who were residents in Albania for at least the last five years. The social pension amount would be equal to the partial pension calculated by 15 years of insurance pegged to the minimum wage.

Second, the State supplementary pensions for constitutional functionaries including, among others, academics and military personnel, were revised in order to adjust the link between contributions and benefits as well as to reduce the State subsidy. The retirement age for members of parliament and ministers was increased from 55 to 60 years, with an increase in the supplementary contribution rates by one percent of gross wage as well as modification of the benefit calculation formulae and methods.

Third, the retirement age for underground miners was reduced by five years (from 60 to 55) but with an increase in the contribution rate by 5% of the gross wage.

This reform guarantees the maintenance of benefits at a normal level and provides an important improvement, compared to the pre-reform scheme, with regard to financial sustainability and adequacy. In the pre-reform scheme, the replacement rate would have been decreased drastically from 36% to 6.2% by 2080. By contrast, the reform guarantees a replacement rate that would never fall below 30 percent. While this pension is not generous, it is expected to keep the elderly out of poverty while remaining affordable. Those who wish to receive a higher pension can do so by saving additionally through voluntary pension funds. Hence, voluntary pension funds can compensate for a reduction in pension entitlements, and thus make the reform more palatable to the general population.

VOLUNTARY PENSIONS

While supporting the reform of Pillar 1, a review by the World Bank in 2013-14 (Price, 2014) recognized that private pensions needed attention if they were to play the intended role of complementing the first pillar. In considering solutions, it was recognised that:

- Necessary individual, market and employer consensus, and experience did not yet exist to move quickly to any form of mandatory private pensions.
- Employers were seen as the most effective channel to raise voluntary coverage and enable a possible move to auto-enrolment. Employers were in a better position to negotiate lower fees and claim tax incentives. Also, PMC marketing to and through them would be more cost-effective.
- Increasing voluntary coverage would require higher public awareness and confidence in pensions – as developing an understanding and consensus for change would be central to durable reform.

On the basis of this analysis, the World Bank and the AFSA agreed to establish a two-year project, funded by the FIRST Initiative, to assist the Authority. This project was completed in May 2016 and had two components:

1. Strategies for expanding voluntary pension coverage, and
2. Improving supervision to enhance public trust in the voluntary system by implementing a risk-based oversight methodology, drafting amendments to regulations and the legislation, and providing guidance to the AFSA to support Outcome and Risk-Based Supervision (ORBS).

The project identified low coverage as the biggest risk in the pension system and that creating trust was a necessary, though not sufficient requirement for tackling this risk. It was essential to use the employer as a channel if an efficient voluntary (or mandatory in the future) pension system was to be built. Individual voluntary pension accounts were commonly charged a fee of 3% of AUM – which was the upper limit prescribed by the law. While these fees were not very high, especially for a small, young pension system, it did not make much financial sense for many to use this system to save for their old age. However, one pension management company decided to levy a lower fee of 1.5% on assets – which was more acceptable to employer-sponsored pension plans. Combined with an employer contribution and reformed tax relief, this provided a ready platform for expanding voluntary pension coverage in Albania.

By focusing on employers, the strategy was to focus on widening the participant base so as to include a broader range of workers instead of only the higher income individuals who are the normal early-adopters of voluntary private pensions. Moreover, there was an explicit aim to develop an effective and secure voluntary pension system that would provide the experience, rationale, and credibility for bolder steps in the future. This is in contrast to some reform efforts where pension reforms were approved in advance of developing the regulatory and supervisory foundations (for example Mexico's 1992 'SAR' reforms)[4].

The starting point for the project was the need for better information on the potential market. This was achieved through a ground-breaking survey, designed jointly by the project team, AFSA and the INSTAT. This survey provided statistics on the market and information on the understanding of employers and employees about pensions in general and voluntary pensions in particular. To expand coverage efficiently, it was essential to segment the market. The survey, therefore, provided the average annual salary (including bonus) per employee for each business activity be split into four size classes, with a range of the number of employees per company, highlighting those with a salary above the overall average salary.

Based on the survey, the following conclusions were drawn:

1. The level of knowledge of private pensions, among both employers and employees, was very limited, due to limited marketing of voluntary pensions.
2. Trust in financial institutions in Albania was below average.
3. The business climate and cost factors were important elements in limiting the demand for voluntary pension products.
4. The difficulty in claiming tax benefits on contributions prescribed under law had impeded the pensions' market development, especially up until January 2015.

It was concluded that PMC's needed to develop more proactive marketing campaigns and increase their efforts on acquiring new private pension participants, primarily through employers. An improvement in the delivery of fiscal incentives for pension products would also stimulate demand. Also, steps should be taken to raise public awareness of the

[4] The 1997 reforms in Mexico were subsequently based on secure regulatory foundations.

security and benefits of pension products especially among individual employees. This would require a combined effort by the Government and AFSA.

The survey (AMF, 2016) was published, and its results were presented at a well-attended and publicized national conference organized by AFSA as a first step to raising employer and public awareness. Stakeholders at the conference highlighted the importance of building on the past reforms to public pensions with new measures to expand coverage of private pensions. This was expected to build a diversified pension system that would help Albania tackle more effectively important demographic and development challenges. The conference achieved its objective of raising awareness through extensive media coverage, including substantial coverage in national television and print media. In addition, the employers who attended the conference gained an improved understanding of the business case for private pensions.

The survey findings, coupled with the conclusions from the conference, enabled the project team and the Authority to prepare a voluntary pension coverage expansion strategy. This strategy identified several initiatives for increasing public awareness and coverage, including:

1. Increasing resources within the Authority dedicated to coverage expansion;
2. Commissioning a new, follow-on survey, including smaller, focused surveys aimed at specific groups of employers, employees, and professional groups;
3. Information dissemination sessions targeting employers and professional groups comprising 5 to 10 persons. (The first three of these were piloted as part of the project, and were well-attended and well-received);
4. Improved communication outreach and information dissemination through the Authority's website, including the publication of conference proceedings to highlight key issues, coupled with debriefing meetings with journalists, successfully piloted during the project;
5. Encouraging targeted interventions by pension management companies for expanding voluntary pension coverage using acquisition plans based on the 2015 survey results. Guidance material to facilitate marketing plans was provided to the PMCs;
6. To measure the success of such initiatives, outcome measures and targets were established and agreed upon including a focus on meaningful long-term outcomes for members, expanded coverage and an increase in AUM.

It was agreed that the Authority had to act decisively to enable the effective application of the law and administrative provisions governing tax relief on pension contributions which, when the project started, were not working effectively and had adversely impacted coverage expansion goals. The project team held several consultations with the Finance Ministry on relevant issues and the minister was invited to address the October 2015 conference. The project team also provided information on the structure of tax incentives as well as related administrative and implementation arrangements to the ministry. In early

2016, the Finance Ministry made relevant changes to the tax code so as to align it with the pension law. These changes were related to the ceiling on contributions eligible for tax benefits and the processes by which employers could obtain tax relief for their employees.

The Authority also adopted an Outcomes and Risk-Based Supervision model for pensions, based on a new manual for supervision, so as to build greater trust in the security of voluntary pensions and to improve system efficacy. The Risk-Based-Supervision Manual of voluntary private pension funds was approved by the Authority Board on 29 September 2016.

A recent change to the social security law, designed to stimulate private pension savings, has further streamlined and strengthened the relationship between the Pillar 1 reform program and voluntary pensions. This legislative change permits private and public sector employers the right to create co-financed professional pension funds that are based on collective agreement, closely akin to the occupational pension plans found in many other jurisdictions. These would take the form of professional (work-based) pensions as are already permitted by the voluntary pensions law. The Supervision of these schemes will be carried out by the Albanian Financial Services Authority.

ACHIEVEMENTS AND **EARLY OUTCOMES**

PILLAR 1 REFORM RESULTS

Implementation of the new Pillar 1 pension reform began in January 2015. The results over the following two years have been positive and in accordance with the prognosis and projections made in the design process. Some of the results are:

- Pension entitlements can now be accrued at a higher level than was possible under the previous law. For the first time, the entitlements are higher than the maximum administrative ceiling set under the previous law, thus providing a more equitable return in terms of pension entitlements from contributions paid over the years;
- The newly introduced social pension has been provided to around 2,300 people aged over 70 years who have zero or minimal other income. Social pensions for this cohort improve their finances and consequently their lives, and also reflects the care provided to the elderly by the social security system.
- The number of new pensioners in 2015, the first year of the reform, decreased by 1,632, due to the increase in the retirement age for women by two months per year and the change to the invalidity pension requirements.
- For the first time, the past trend of an increasing deficit has been reversed and a moderate reduction in the Pillar 1 pension scheme deficit was achieved. Although the reform effects will become more visible in the long-term, an immediate positive

impact on the scheme deficit is a very significant and promising signal for its future success and sustainability.

- Crucially, within a short period, the number of contributors has increased by around 180,000 members (20%). A corresponding improvement in declaration of real wages has been observed also, reflecting the importance of transparently linking contributions and pension entitlements.
- An overall improvement in the sustainability and transparency of the Scheme.

VOLUNTARY PENSION RESULTS

Between late 2014 and September 2016, the voluntary pension scheme had also witnessed a quantum jump in terms of both voluntary coverage (by 88%) and AUM (by 90%). This was largely due to an increasing number of employers (106 till date) that have established professional (work-based) pension schemes. There is also some evidence that PMCs have increased their own marketing efforts.

Anecdotally, trust in the system appears to be improving – employers and management companies that were spoken to at the end of the project said this was less of a barrier.

The employer tax reclaim system is now working effectively and in accordance with the law that stipulates that the contribution of the fund member, as well as contributions made by the employer, are considered deductible from taxable income up to a specified limit. Returns on investment are exempt from tax, while benefits are taxable under personal income tax law. Feedback from PMCs and employers indicates that the administrative improvements needed to make the law effective have worked as intended. Difficulties, however, remain for self-employed and other individual contributors trying to reclaim tax on contributions. Actions in this regard, including steps to improve access by the informal sector and other desirable enhancements have been the subject of continued dialogue between the Authority and Ministry of Finance.

REMAINING **CHALLENGES**

Although the Pillar 1 reform has addressed many of the problems originally identified, certain immediate and some longer-term challenges for the first pillar remain.

For example, participation in the compulsory social insurance scheme by the self-employed in the agricultural sector is low. This is due to several factors including small farms, which are often non-productive, and behavioural issues around retirement savings. Another obstacle is the rules that require a gradual increase in the requisite contribution amount from farmers, until it equalizes the urban self-employed contribution levels.

Another important challenge is related to emigration that had been denied to the Albanian population during the prolonged communist rule. In the 1990s, upon dissolution of the state enterprises and agricultural cooperatives, extensive migration served as a safety-valve to ameliorate the grave social and economic problems of the country. A third of the overall population, mostly younger workers registered in the National Registry, have now emigrated. As the financing of the first pillar is based on a PAYGO principle and inter-generational solidarity, a high level of youth emigration has created significant problems in financing the scheme. Under these circumstances, it is very important that social security coverage be extended to migrant workers and appropriate mechanisms be established so that pension benefits accumulated in different countries can be aggregated for entitlement to pension benefits. Yet, instituting such mechanisms is difficult.

The Albanian Government has, therefore, been actively involved in negotiating bilateral social security agreements and processes with several countries. These would provide the acknowledgement and aggregation of the social insurance periods of migrants. Albania already has effective social security agreements with Turkey, Belgium, Hungary, Macedonia, and Luxembourg. In addition, there are agreements with countries that have entered the ratifying process, including the Czech Republic, Germany, and Romania. Agreements concluded with Austria and Canada are presently under the signature procedure. The government has also initiated negotiations with Kosovo. Accession to the EU will, along with the rights as a Member State, entitle Albania and oblige EU countries, to establish bilateral social security agreements between them, and, consequently, enable the aggregation of social insurance periods required for the provision of entitled benefits to migrant workers and their households.

The work-related disability benefit provisions need to be revised in order to provide this benefit to people who genuinely are too disabled to work and to reintegrate them in the labour market after training and rehabilitation. This challenge encompasses also the equal treatment of all disabled persons. Invalids, who have been in employment and have paid contributions into the social security scheme (that in turn helps determine their level of eligible benefits), may sometimes receive lower benefits than disabled persons who have never worked and who could receive a more generous, flat-rate benefit financed from the State budget.

For voluntary pensions, the major residual challenges are centered on (a) overcoming the continuing lack of awareness and resistance to participating in voluntary pensions and; (b) delivering higher risk adjusted returns by reducing the fees charged by PMCs and improving their investment sophistication and diversification especially as the volume of pension assets grows. The Authority will, therefore, need to continue its efforts at voluntary coverage expansion and on maintaining the security of the system as well. As voluntary participation and public confidence in the system grows, the foundations are being laid for further coverage expansion – either through auto-enrolments or by mandate. The challenge will be to make such an initiative publically acceptable. Improved returns on pension assets may also have a positive impact on coverage and persistent contributions. However, improving net returns would depend in part on the development of effective domestic financial markets and other suitable investment opportunities. All this would take time. And it would involve sustained efforts on changing public attitudes.

The high level of informality in Albania places a fairly modest upper limit on voluntary pension coverage through employer-sponsored private pensions. This problem has been arrested to a certain extent as recent Pillar 1 reforms, that have addressed the traditional challenge of employers under-declaring employees and salaries, have helped reduce informality. However, sluggish economic growth restricts the funds available for pension contributions by employers. The current ceiling on tax relief for contributions (USD 1,600 a year) also makes voluntary pensions less attractive for employers. A higher tax-relief on contributions, as well as a removal of tax on pension benefits during the pay-out phase is now being considered and is expected to have a positive impact.

As highlighted in Box 12.1, it is important to integrate pension coverage and financial inclusion initiatives. Going forward, it will be necessary for the voluntary pension system to actively leverage digital financial inclusion infrastructure in providing secure and convenient access, as well as lower costs of contributions collection and benefits delivery. Equally, the Albanian pension system could benefit vastly from the experience, expertise, and innovation of mainstream financial institutions in asset management, distribution, and governance. Such a strategy would enable Albania to address the challenges of low coverage and informality more effectively than would be possible with a more 'traditional' approach to pension reforms and implementation. In this context, the ideas reviewed in the thematic and country chapters in this volume provide a road map that could be taken forward in Albania.

Box 12.1

Financial Inclusion in Albania

Financial inclusion in Albania is significantly lower than in the surrounding countries. In 2014, only 38% of the adult population had a bank accounts (and 8% had some formal savings) compared to 60% and 72% of adults with a bank accounts in Montenegro and Macedonia respectively. Banking access has even higher rates in some neighbours such as Greece and Italy. This is in part a reflection of relatively low levels of formal employment and places limitations on the scope for work-based pensions to gain wide coverage. A mobile payments platform like M-PESA could serve as a vehicle for extending financial inclusion, especially given that mobile penetration is 100% in Albania. M-PESA was launched in Albania in May 2015. Mobile payments could be a more effective tool for collection and disbursement of pension contributions and benefits if a sufficiently accessible electronic payments infrastructure was supported and integrated with a biometric national ID.

DATA AND ID

Albania has implemented a national ID with embedded biometric data (finger-print recognition) to help uniquely identify citizens. In addition, the Social Security Institute has now digitised its records, putting all the previously paper-based records in an online system that allows members to view their records. This means that important ground-work has been laid for the kind of unique identification, tracking and interoperability that will ultimately be needed if some of the innovations highlighted in other chapters in this book volume are to be introduced in Albania.

BANKING AND PAYMENTS

Albania has been developing its banking and payments infrastructure in recent years. Vodafone and its M-PESA mobile payment platform have recently begun operations in Albania. Thus far however, bank charges for payments and transfers have remained relatively high with minimum charges of USD 1.60-3.90 for inter-bank transfers and cash withdrawals within Albania. However, electronic banking is becoming increasingly important as 14 out of 16 banks offer this service to their customers, which provides encouragement for further digital finance innovations.

FUTURE DEVELOPMENTS

The pension inclusion strategy pursued thus far has been to develop a more robust foundation for the pension system, and focusing on coverage expansion through employers and tax incentives. Building on such foundations makes sense as a precondition for a broader expansion. Leveraging digital financial inclusion infrastructure for pension coverage expansion could be pursued in the next wave of reform. However, the issue of high transaction charges and the continued difficulty for individuals (as opposed to employers) claiming tax relief on individual contributions, could prove to be important obstacles.

LESSONS LEARNED

The key lesson to be learned from Albania's pension reform is that improving pension inclusion will often involve a range of complementary initiatives. In this case, sustainable improvements to pension inclusion depended on parametric changes that potentially limited Pillar 1 retirement incomes for higher income workers. This change could only be made publically acceptable because of the availability of voluntary pension products to supplement Pillar 1 pensions for higher earners. This strategy has so far proved effective. However, the adoption of voluntary pensions by employers has been slow because of issues related to awareness, trust, domestic financial markets, and resistance from employers due to difficulties in claiming tax benefits. Each of these issues had to be addressed for the whole system to work effectively.

The current and future demographic challenges faced by countries such as Albania, along with slow economic growth and consequent budget constraints, make it difficult for a Pillar 1 pension system to adequately fulfil the retirement needs and expectations of all citizens. It is necessary that working age citizens should, as far as possible, start to save money during their active years for a better life in old age. The best way to save money and to maximise returns is to participate in both the public and privately funded pensions. Such behaviour would improve the life of plan participants, reduce the cost for society as a whole and avoid over-burdening the State budget. Everyone, and especially governmental agencies, need to work hard to communicate this message.

Albania's voluntary pension program has demonstrated that an approach based on robust evidence, coupled with awareness raising activities, can improve voluntary pension coverage despite strong adverse factors. It also shows that tax relief incentives for pension saving will only work if the practicalities of implementation receive sufficient attention and that achieving this may require a multi-agency approach drawing on international experience. A strong pension system needs well-functioning financial markets. The voluntary pension proposition is much easier to communicate if funds are seen to be delivering attractive net investment returns.

Finally, trust is the prerequisite for any pension system. Trust takes significant time and effort to build but is very easy to lose. Employees and employers need to trust that contributions to a Pillar 1 system will result in increased retirement income and that private pension funds are secure regardless of the survival of the fund administrators. Otherwise, there will be wide-scale avoidance of mandatory contributions that in turn impacts any complementary occupational system. The development of this trust required changes to Pillar 1 to make it fairer, coupled with visible measures to enhance private pension security.

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