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The Social Safety Net in Albania

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Abstract

This paper reviews the developments in the social safety net system of Albania since the beginning of its economic adjustment program in mid-1992 through the third quarter of 1995. It shows that the social safety net system was quickly reformed, and that this allowed Albanian authorities to support the most needy groups of the population with income transfers. Notwithstanding the low administrative costs, the social safety net system is not financially sustainable. Expenditures are not balanced with revenues, and the gap cannot be closed in the short-run. Poor targeting of the benefits and administrative loopholes spur expenditures. Revenue growth is hindered by low compliance with the social security contributions. The paper concludes with some suggestions for addressing this issues.

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<u>Contents</u>	<u>Page</u>
Summary	iii
I. Introduction	1
II. Structure and Financing of the Social Safety Net	1
III. The Social Security System	2
1. Revenues of the Social Security Institute	2
a. Legal framework	2
b. Social security contributions	3
c. General administrative procedures	5
d. Measures to improve compliance	6
2. Expenditures of the Social Security Institute	9
a. The pension system in Albania	10
b. Maternity benefits	16
c. Sickness and work-related injury benefits	19
d. Unemployment support	21
IV. Social Assistance	28
V. Price subsidies and compensation	33
VI. Conclusion	38
Tables	
1. Financing of the Social Safety Net	39
2. The Composition of the Social Safety Net System	40
3. Social Security Contribution Rates Across Europe	41
4. Compliance with Social Security Contributions in 1994	42
5. Pension Benefits in Albania	43
6. Average Pension Benefits in 1993-95	44
7. Number and Composition of Pensioners	44
8. Disparities in Number of Children Per Woman	45
9. Evolution of Unemployment	46
10. Unemployment in Selected Regions	47
11. Differentiation in Social Assistance Benefits by Family Size	48
12. Composition of Social Assistance Benefit Recipients	49
13. Cost of Social Assistance Benefits	49
14. The History of Price Compensation	50
15. Eligibility for Energy Compensation	51

Charts

1.	Revenues of the Social Security Institute	52
2.	Distribution of Pension Benefits, 1994	53
3.	Changes in the number of Recipients of Unemployment and Social Assistance Benefits	54

References	55
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Summary

Following the collapse of central planning, Albania, as other Eastern European countries, had to remodel its social safety net system to cushion the most vulnerable groups of the population from the adverse effects of the economic transition. This was a particular challenge for Albania since, before launching its economic adjustment effort, it was the poorest country in Europe and was experiencing extremely rapid increases in unemployment.

This paper summarizes the main developments in the social safety net system in Albania from the beginning of its comprehensive economic adjustment program in mid-1992 through the third quarter of 1995. It defines factors that have undermined the financial soundness of the social safety net system and provides some recommendations on how the situation might be improved.

Being essential for supporting the poorest groups of population with income transfers and administering social security benefits, the social safety net system in Albania remains financially insecure. Strict compliance with the social security contributions and improved targeting of social assistance benefits are crucial for the financial stability of Albania's social safety net in the longer run.

I. Introduction

The rapid pace of price liberalization and the downsizing of Albania's government and state enterprise labor force during 1991-93 led to a shift in the distribution of income, from the state sector toward the rural market economy. Partly in response, government expenditures for pensions, social assistance, unemployment support, and other cash transfers to households rose from 8-10 percent of GDP in the late 1980's to 14-15 percent of GDP in 1992-93. The presence of an expanded social safety net reduced the human cost of transition and helped to maintain a consensus in favor of economic reform. Remittances from family members overseas and the early redistribution of rural land from the former state farms and cooperatives to nearly 500,000 farm families also formed important buffers.

Social safety net expenditures have since declined in real terms (Table 1), in response to declining unemployment, rising private sector incomes, and stricter enforcement of eligibility requirements. The financial situation of the social security system was also improved by legislation in 1993 which narrowed the possibilities for early retirement and established a new system of contributions, including a phased increase in contribution rates.

Nevertheless, the financing of the social safety net places a large burden on the budget and there are longer-term factors that will tend to worsen this financial imbalance in the coming years. These include demographic trends, the likely persistence of a relatively high rate of core unemployment in the coming years, a tendency to enact new legislation widening eligibility for both contributory and non-contributory social benefits, the narrow contribution base, and poor compliance with contribution requirements. A significant improvement in this situation will require measures both to control expenditures (mainly by restraining the scope of and eligibility for benefits) and to increase revenues (through improved enforcement of contributions). Improvements in the legislation and the administrative capacity of the social safety net system are needed in order to make the social safety net system financially sound.

II. Structure and Financing of the Social Safety Net

Albania's social safety net consists of the social security system, social assistance, and price subsidies and compensation. The general characteristics of these programs are summarized in Table 2.

The social security system is responsible for collecting social contributions and administering the pension system, maternity and sickness benefits, and unemployment compensation. Issues relating to the social security system are discussed in detail in Section III.

Social assistance is intended to provide support for low-income families who are not covered by other aspects of the social safety net (see Section IV). Price subsidies, which are paid by the budget to producers in

order to reduce the consumer price of sensitive products, have been reduced progressively since 1992; to help cushion the impact of the corresponding increases in retail prices, the budget has included provision for temporary cash transfers to households (see Section V).

The expenditures of the social security system are financed by contributions (levied on both employers and employees), supplemented by transfers from the central government budget. Other elements of the social safety net are noncontributory and financed entirely from the budget. The burden on the budget for the financing of the social safety net has declined significantly since 1992, due to increases in contribution rates and a reduction in the number of beneficiaries of both unemployment compensation and full social assistance in rural areas. The net budgetary cost of the social safety net was about 7.7 percent of GDP in 1994 and was expected to decline to 6.4 percent of GDP in 1995. (Table 1).

III. The Social Security System

The social security system in Albania is administered mainly by the Social Security Institute (SSI), through its local branches. The revenues of the SSI are derived from payroll contributions levied on employers and employees, and budgetary transfers. The expenditures of the social security system include pensions, maternity and sickness benefits, unemployment compensation, ^{1/} and other noncontributory benefits (mainly for former political prisoners).

Under the system of central planning, lifetime employment was guaranteed by the state, there was no private economic activity, and there was little relation between contributions to "social insurance" schemes and the various categories of benefits provided by the Government and the public enterprises. The present social security system, established through the enactment of Social Security Law No. 7703 in May 1993, rationalized the various systems of contributory social benefits and provided some initial steps toward better financial balance. The latter included a phased increase in contribution rates, reduced replacement ratios for most benefits, and a gradual tightening of provisions for early retirement. Nevertheless, the system is still financed mainly by transfers from the budget.

1. Revenues of the Social Security Institute

a. Legal framework. Article 66 of the Social Security Law outlines three revenue sources for the Social Security Institute: social security contributions, transfers from the central budget, and investment gains of the Social Security Fund. Actual revenues in 1994 consisted of social security contributions (3.7 percent of GDP), and budgetary transfers

^{1/} Unemployment insurance, which is legally a part of the social security system, is administered by the Ministry of Labor through its local offices.

(2.7 percent of GDP) (Chart 1). At present, the only investments are working balances maintained in the banking system, which do not yield significant interest income.

b. Social security contributions. The statutory contribution rate is set by the Social Security Law at 42.5 percent, and is paid by employers (32.5 percent), and employees (10 percent). The social security contributions are levied on gross wages of employees, between a floor and a ceiling, which were set for 1995 at 3,180 leks and 9,360 leks respectively. As a transitional arrangement the Government contributed during 1993-95 a portion of the employees' share of social security contributions as follows: 10 percent in 1993; 7 percent in 1994; and 4 percent in 1995. This arrangement has been discontinued in 1996.

The social security system in Albania is a compulsory publicly managed system. All working individuals are required to contribute to the Social Security Institute. But the contribution rate and the timing of contributions differ for various groups of contributors, based partly on the social security benefits available to the different groups. Thus, public and private sector employees in the cities are eligible for pension and unemployment benefits, maternity, sick and work-injury benefits, while urban self-employed and farmers are eligible only for maternity and pension benefits. Thus, the rate of social contributions is significantly lower for self-employed and farmers (34.5 percent of the minimum wage ^{1/}) compared to public and private sector employees in the cities (42.5 percent of the gross wages within the band of 3180-9360 leks). Farmers were granted an additional tax break--they are required pay only 9-15 percent of their social contributions, depending on the quality of land, with the rest made up by the government. This provision is expected to be discontinued in January 1997.

Social security contributions collected in 1994 financed only 50 percent of total social security spending, including the SSI expenditures and financing of unemployment support. While this gap is unlikely to be closed quickly, it is necessary to seek a better balance between revenues and expenditures of the SSI, and revenue increases are an essential part of this effort. As discussed below, contribution rates are already high, so the major focus will need to be on improving compliance--particularly by the private sector.

In principle, there are three ways to increase SSI revenues:

(i) Increase the social security contribution rate. The statutory social security contribution rate cannot be raised significantly for 3 reasons: a) It is already high by international standards (Table 3), and

^{1/} The Law refers to the lower boundary of gross wages on which social security contributions are levied as a minimum wage--leks 3180.

Albania can ill-afford to increase disincentives to employment unnecessarily in the face of high unemployment; b) The introduction of health insurance contributions, beginning from March 1995, raised the overall payroll contribution rate even further to 45.9 percent; c) The rate of compliance is low for much of the population, even at the existing rate.

(ii) Develop a supplementary revenue source that is not dependent on payroll taxes. Experience in other countries suggests that if a non-payroll tax were to be used as a supplementary revenue source, the most likely candidates would be broadly based taxes such as a surcharge on the VAT or the income tax. However, in Albania such an approach would appear premature, since the VAT has not yet been introduced and the income tax is not a major source of revenue. The need to increase tax revenues to improve public sector savings in general underscores the urgency of timely implementation of the VAT at an appropriate rate.

(iii) Improve compliance with social security obligations. 1/

The overall rate of compliance with social security obligations in 1994 was 89 percent, and it ranged from more than 94 percent for budgetary employees, to less than 40 percent for farmers (Table 4). Urban private sector compliance with social contributions was under 78 percent, and there is reason to believe that this figure is an overestimate since the registration by private sector employees is not complete, and there is evidence of income under-reporting. One of the reasons for the low registration rate is the time consuming re-registration procedure which is supposed to be repeated each time an employee is hired or laid-off. The number of contributors in the public sector is also likely to be under-reported, which at least partially results from imprecision in delineation of budgetary and non-budgetary institutions, and also uncertainty in distinguishing active from inactive state enterprises. Generally the low levels of social security benefits, the low level of incomes, and demographic structure have a negative impact on the compliance with social security contributions. District offices of the SSI do not have enough incentives to follow up closely on the completeness of registration and compliance with social security contributions, since the transfer from SSI Headquarters covers the shortfall between revenues and expenditures.

The importance of improving compliance with social security obligations goes beyond the potential for immediate revenue gains, whether these are equivalent to 11 percent of present collections or 2-3 times that much. The number of budgetary and public enterprise employees will continue to decline in the coming years, while private employment is growing rapidly. Thus,

1/ Most of the countries in transition experience low compliance with social security contributions. This might be explained by the fact that under central planning social security was primarily a public good. This notion has not changed significantly, so that "free riding" appears to be a serious problem for the social security system in transition.

unless adequate incentives and enforcement mechanisms are put in place with emphasis on the private sector, the overall compliance with social security obligations will erode further.

c. General administrative procedures. The SSI is the only institution in charge of collecting social security contributions. Contributions are collected by district branches of the SSI, which retain collected contributions and use them to finance expenditures. Revenues of the district SSI branches are supported with transfers from the SSI Headquarters in case they fall short of funds. If social security contributions exceed expected expenditures in a certain district, the surplus is supposed to be transferred to the SSI Headquarters. Since the SSI budget is a part of the central budget, this mechanism of resource reallocation is neutral for the central government budget. However, the existing mechanism of resource reallocation does not improve incentives for local SSI branches to keep their budgets balanced.

Social security contributions are collected through the National Commercial Bank in urban areas, and through the Rural Commercial Bank in rural areas. The banks are not allowed to release money for wage payments unless a firm's social security contributions have been paid. Beginning from the second half of 1994, the banks have actually implemented this requirement which resulted in some improvement in the collection of social security contributions from non-budgetary institutions, private businesses and self-employed.

According to the Law, certain social security contributions are financed out of the budget. These include social contributions made for budgetary employees, part of public sector employees' contributions during 1993-95 (4 percent of the wage bill in 1995), part of farmers' contributions, contributions for unemployed, and all non-contributory benefits. ^{1/} Thus, the financial soundness of the SSI depends significantly on budgetary transfers.

The existing mechanism of budgetary transfers for social security contributions creates at least three problems:

(i) The SSI does not have strong incentives to enforce compliance since any revenue shortfall is covered out of the budget. Two factors have prevented the Government from getting rid of this responsibility:

-- the Law stipulates that the government should cover the SSI deficit; and

-- the benefits paid by the SSI are all entitlement benefits.

(ii) The existing mechanism for paying social security contributions by budgetary institutions creates inefficiencies in the use of budgetary

^{1/} These include benefits for the ex-politically persecuted and their families, state and merit pensions, and partial disability pensions.

resources. For example, the Ministry of Finance makes transfers to budgetary institutions according to employment ceilings and funded wage bills, while budgetary institutions adjust downward the amount of the social security contributions they pay to the SSI to reflect the actual number of employees and wage level. The amount of budgetary transfer for public employees is also excessive since it is not adjusted to the wage floor and ceiling within which contributions are being levied.

(iii) Control over public sector compliance with social security obligations is also complicated in the absence of clear definitions of budgetary and non-budgetary institutions.

d. Measures to improve compliance. The following would appear to be the most productive avenues for improving compliance:

Terminate unlimited budgetary financing of social security contributions. However, the PAYG (Pay-As-You-Go) system ^{1/} makes it complicated since the benefits are being financed from current social security contributions. It is desirable for the Government to limit its responsibility for coverage of the SSI deficit. This would require separating the management of contributory ^{2/} and non-contributory benefits. The Government would remain in charge of financing non-contributory benefits.

In the short-run, the Ministry of Finance should avoid transfers to budgetary institutions in excess of their actual obligation for contributions. In order to improve the use of budgetary funds the Ministry of Finance might introduce a periodic reconciliation of the amount of social contributions made by budgetary institutions to the SSI with respective transfers by the Ministry of Finance.

Annual reconciliation of the Ministry of Finance's list of employment in budgetary and active non-budgetary institutions with the SSI's records would also help the SSI to keep track of social security obligations to compare with contributions collected.

With the assistance of the World Bank, the SSI has started to develop actuarial methods for assessment of contributions and a system of financial management.

Improve private sector compliance. In 1994, less than 16 percent of total social security contributions were collected from the private sector

^{1/} Pay-As-You-Go schemes are usually run by the state. They are based on the fact that the state does not need funds in anticipation of future pension claims, but can tax the working population to pay the pensions of the retired generation.

^{2/} Including unemployment benefits, which are contributory benefits although they are currently financed from the budget.

(including farmers), while employment in the private sector (urban and agricultural) was close to 70 percent of the total employment. Rough estimates suggest that compliance with social security contributions in the private sector is 21 percentage points below the rate of public sector compliance. (Table 4)

The nonagricultural private sector does not have strong incentives to contribute to the SSI. The urban private sector consists mostly of small or medium-size enterprises. In many cases jobs in small private firms are considered temporary, which create disincentives for both employers and employees to participate in the social security system. Social security contributions increase employers' labor costs, thus reducing their competitiveness. Employees are not interested in contributing to the SSI because current consumption is preferred to future consumption--people rely more on personal savings rather than on the public system given the uncertainties of the transition period. The expectation that the Government would provide social protection at the subsistence level irrespective of contributions paid is also a disincentive for contributing to the SSI.

Improving private sector compliance with social security contributions depends on linking the benefits to contributions paid. In the long-run, the social security system for private sector employees should become funded; benefits would depend entirely on past savings. 1/

In the short-run, improvement in information systems, which would assist in detecting non-compliance, might strengthen incentives for private sector employees to participate in the social security system. It is also important that benefits depend on a documented record of compliance. Introduction of personal identification social security numbers, and in the meantime, of temporary booklets confirming the period of social security contributions should be used for improving the administration of benefits. 2/

Farmers have the lowest rate of actual contributions to the SSI. There are several reasons for their not participating in the social insurance scheme:

(i) Benefits are flat rate, and set at a level below the subsistence minimum. The Government pays part of farmers' social security contributions, and social security benefits are completely independent from contributions paid. Farmers are eligible for only limited social insurance --pension and maternity benefits--which also reduces incentives for contributing to the SSI;

1/ Early introduction of the funded system is complicated by under-development of financial markets.

2/ Previously work books were used, as in other transition economies. These documented work contribution history. But their use is no longer mandatory.

(ii) Easy access to social assistance makes participation in the social security system even less attractive;

(iii) Many of the farmers view the social insurance as a voluntary scheme. Only 10 percent of farmers were registered with the SSI in 1994, and this figure was expected to decline in 1995;

(iv) Huge farmers' arrears to the SSI accumulated in 1993-95 are an obstacle for re-entering the social insurance scheme; the majority of farms are small and incomes are low. For most of the farmers, accumulated arrears (including penalties) with the SSI have reached the level of their annual income;

(v) Agriculture is a rapidly growing sector with huge investment needs. Farmers prefer to invest in their farms rather than to contribute to the SSI;

(vi) Inconvenience of payments through Rural Commercial Bank (RCB) branches further reduces farmers' incentive to contribute to the SSI.

Incentives for farmers to contribute to the SSI might be improved if the linkage between the contributions paid by farmers and the level of benefits were strengthened. The first step is to discontinue the arrangement under which farmers contribute only part of their contributions (depending on quality of land), and the government covers the rest. Applicants should not be entitled to benefits without a documented record of paying social contributions.

In the longer run, the level of benefits should be based on the amount of social contributions paid. A separate social security regime which would better fit farmers' needs might also be established in the longer-run. Establishing locally managed supplementary social security schemes might also be considered.

Public enterprise employees. Before 1994, state enterprises contributed 59 percent of total social contributions, while their share in total employment dropped from 53 percent in 1992 to 22 percent in 1993. In 1994, state enterprises were the second largest contributor after budgetary institutions, while employment was further reduced to 14.5 percent. Despite the reported relatively high state-enterprise compliance rate, the SSI faces increasing difficulties with collecting their social contributions due to the deteriorating financial situation of most public enterprises. According to the SSI, default payments of state-owned enterprises in 1994 were about 3.7 percent of the overall collected contributions.

In the longer run, state enterprises are not likely to be an important source of SSI revenue because of their poor financial situation, diminishing number of employees and ongoing privatization. SSI arrears (along with tax arrears) are being used as a means of financing the deficits of the

remaining enterprises, given enterprises' almost total lack of access to bank credit and existing arrangements to avoid inter-enterprise arrears.

Enterprise Restructuring Agency (ERA). 1/ Arrears to the SSI accumulated by ERA enterprises account for 14 percent of the total amount of state enterprise arrears. The social security contributions of the ERA enterprises are financed out of the budget. The mechanism is the following: the funds are transferred to the ERA, and the ERA passes them on to enterprises to be used to pay social contributions. The enterprises are likely to defer the payment, however, since they can temporarily use the funds for other needs. The SSI, ERA and the Ministry of Finance should coordinate their activities to strengthen control over payments of social security contributions by these enterprises.

Budgetary employees. Budgetary institutions are now the main contributors to the SSI. However, their compliance rate is less than 95 percent, and payments are often deferred. An increase in total value of social security contributions from budgetary institutions is unlikely given ongoing cuts in budgetary employment. Nevertheless, the mechanism for collecting social security contributions from budgetary institutions must be improved in order to eliminate leakage of budgetary resources. As stressed above the Government has to make financing of the wage-bill for the budgetary institutions conditional on contributing to the SSI, and restrict the use of budgetary transfers for social security contributions. Budgetary transfers in excess of liabilities to the SSI should be refunded to Treasury.

Additional obstacles to improving compliance with the SSI obligations. "Grey market" employment is a significant obstacle to the growth of social security contributions. Presently less than 38 percent of the total number of employed are contributing to the social security system. The SSI would not be able to force these people to pay social contributions unless the benefits become more attractive, and the entitlement is linked to contributions paid.

Large-scale emigration (about 350,000) and high unemployment (expected to be 180,000 as of end 1995), which account for more than 30 percent of the labor force, also reduce possibilities for the growth of social security contributions. Rapid aging of the population complicates the situation in the long-run.

2. Expenditures of the Social Security Institute

This section examines the results of implementation of the Social Security Law, and outlines the possibilities to improve cost efficiency of

1/ Enterprise Restructuring Agency was created to facilitate restructuring or closure of the thirty most politically sensitive state enterprises.

the SSI expenditures. The discussion is organized in terms of the main categories of expenditures: pensions, maternity and sickness benefits, and unemployment compensation.

a. The Pension System in Albania

Before the reform the Albanian pension system was characterized by almost universal eligibility for benefits. This made the pension system expensive, although the level of benefits was low. No relationship existed between contributions paid and the level of benefits. 1/ Soft eligibility requirements for early retirement and a short waiting period for full pension raised the ratio between the benefit and contribution periods, resulting in a deteriorating financial situation in the pension system.

The pension system in Albania consists of 4 types of benefits: old-age, disability, survivor's and merit pensions. The pension benefit structure has not changed with the adoption of the new Social Security Law.

The enactment of the Social Security Law in May 1993 has somewhat improved the financial soundness of the pension system. The most important change was that qualifying requirements for full old-age pensions were tightened--they became conditional on contributions paid for 35 years 2/, and the Law envisaged a gradual phasing out of early retirement. However, the growth of non-contributory benefits has offset these savings.

Pension benefits are the major expenditure item of the Social Security Institute. Pension payments totalled 5.4 percent of GDP in 1994, and accounted for about 85 percent of the SSI expenditures. 3/ The share of pension benefits in the SSI spending dropped by more than 10 percent in 1994. This resulted from tightening the eligibility for pension benefits, keeping benefits of rural pensioners almost unchanged, and compressing pensions through a flat rate benefit increase. Two generous increases of pension benefits by 10 percent across the board in May and October 1995 raised pension expenditures to about 6.7 percent of GDP in 1995.

The composition of pension benefits and eligibility criteria are summarized in Table 5.

Although most of the benefits are supposed to be contributory, nearly all of them have mixed financing. For example, occupational pensions, which are a segment of old-age pensions, are partially financed from the budget.

1/ No individual contribution records were kept. The pension was dependent on the work history record derived from the work book held by each worker.

2/ The waiting period for full old-age pension was raised from 25 years for men and 20 for women to 35 years irrespective of gender.

3/ Unemployment benefits are not included, since they are financed out of the central budget and administered by the Ministry of Labor.

The same applies for survivor's and merit pensions. In most of these cases the government either reduced the waiting period, or granted benefit supplements without appropriate adjustments in the contribution rate. Mixed sources of pension financing reduce the SSI's incentives to make greater efforts to improve the compliance with social security contributions.

Legal framework. The pension system in Albania is regulated by the Social Security Law No. 7703, May 11, 1993. The Law is not binding regarding the entitlement for merit pensions and the definition of professional groups eligible for special pensions. The eligibility for early retirement is at the discretion of the Council of Ministers. The Social Security Law was supplemented by Decisions of the Council of Ministers which specified the payment mechanism and rates of social security contributions levied on self-employed and farmers. Other Decisions delineated groups eligible for additional benefits. The augmentation of the Law with numerous Decisions of the Council of Ministers allows for bargaining between the Government and employees in certain occupations, or groups in the population. This escalates the cost of non-contributory pension benefits.

Adequacy of benefits, coverage and duration.

The average pension benefit remains at the subsistence level 1/, although rural and partial pensions fall below it. The coverage of pension benefits improved during 1993-94 and reached 92 percent of the total retirement age group.

The statutory replacement ratio (the average pension as a share of the average wage in the public sector) for full old-age pension is set equal to 75 percent of any three of the last 10 years of the social insurance period. The actual urban replacement ratio in 1993-94 was 50 percent. The estimated rural replacement ratio was less than 33 percent of average monthly income (cash and in-kind) per worker. 2/ 3/

The distribution in the benefits' level is skewed towards minimum benefits (Chart 2). The difference between the highest and the lowest urban pension benefit after the October 1995 increase was 170 percent.

Duration of benefits. The generally low retirement age and introduction of retirement test in 1993 4/, as well as a surge of early

1/ Full old-age base pension is set to be equal to the subsistence minimum level determined by the Council of Ministers.

2/ Based on the assumption of two workers per family.

3/ Agricultural Production in Albania (Socio-Economic Survey, 1993-94), and staff estimates.

4/ A person has to retire from economic activity to qualify for an old-age pension.

retirements in 1993, reduced the average age of new retirees from 55 years old in 1992 to 54 in 1993-94. Given a life expectancy of 73 years, the average retirement period exceeds half of the contribution period.

The level of benefits

Urban pension benefits are usually increased along with wages, which has kept the benefits at least at the subsistence level. Beginning in 1994 pension benefits started to grow in real terms. (Table 6) Thus, during 1994 pensions increased on average by more than 47 percent, while inflation was just 22.6 percent. In 1995, urban pension benefits grew by 18 percent, against a 7.9 percent increase in the CPI.

Partial pensions on average are about 60 percent of the full old-age pension, which leaves them below the subsistence level. Partial pensions are supplemented with partial social assistance benefit if the household qualifies for the latter.

Rural pensions differ significantly from urban, although they are regulated by the same provisions of the Social Security Law. 1/ Rural pensions are flat rate benefits, and the level of rural pension benefit is just about 1/3 of those in urban areas. 2/ Rural pensions do not provide the subsistence minimum. When the overall income of the household is below the subsistence level, partial social assistance could be granted. (See Section IV). More than 19 percent of rural pensioners were poor in 1993-94.

Three main reasons prevailed for setting rural pensions below the urban subsistence level: (1) agricultural land provides additional in-kind income; (2) the role of extended families is more important in rural than urban areas; and (3) low compliance by farmers with social contributions. However, even at this low level rural pensions put a significant burden on the budget--according to the 1995 SSI projections the budgetary transfer for rural pensions reached 0.7 percent of GDP.

Composition of beneficiaries. The majority of pensioners is located in urban areas--67 percent; the remaining 33 percent are rural pensioners. Old-age pensioners account for nearly 76 percent of the total, followed by 14 percent receiving survivors' pensions; the remaining 10 percent includes all other categories of pensioners (disability, merit, etc.). (Table 7).

1/ Before the reform pensions of state farm workers were regulated by the same Social Security Law as pensions of those working in urban areas. Pensions of ex-employees of collective farms were regulated separately.

2/ The reason for this significant discrepancy between rural and urban pensions was that the level of rural pensions is set separately. Initially they were lower than the pensions in cities, and they were not increased during the first year of implementation of the Social Security Law. They were increased at a flat rate in October 1994, and set at 700 leks.

Since old-age pensions account for the bulk of SSI expenditures, this category is the key to restraining the cost of the pension system. The two most expensive provisions that need to be reined in are (1) special occupational pensions, and (2) early retirement. Excessive costs are mostly created by special occupational pensions, which are granted to workers in three categories of difficult occupations and benefit 60 percent of old-age pensioners. ^{1/} Although the Social Security Law envisages gradual increase of the required contribution period and retirement age for those eligible for occupational pensions, it would still take 14 years to make equal the eligibility requirements for retirees in category I occupations with the requirements for a regular old-age pension. For retirees in category II and III occupations this transition would be accomplished by the year 2004.

Occupational pensions impose significant additional costs on the pension system for three main reasons: (i) presently the required service period during which contributions are paid is at least 30 percent shorter; (ii) the average benefit period is longer; and (iii) pension benefits for occupations under categories I and II are higher than average.

Broad eligibility for early retirement has been used to limit the growth of unemployment resulting from the downsizing of both the civil service and state enterprises. Early retirement is usually granted to those who are no more than five years below retirement age, and have completed at least 3/4 of the required service period. Early retirement is an expensive provision since it narrows the payroll contribution base and increases the number of beneficiaries.

Rural pensioners account for only 33 percent of the total number of recipients, and the costs of their pensions have declined to 12 percent of the total since the flat rate rural pensions are low and have been frozen while urban benefits have increased in recent years. Nevertheless, they impose a significant budgetary burden, since they are nearly fully financed out of the budget. This is a result of the government decision to fund 85-91 percent of farmers' social contributions until January 1, 1997.

^{1/} According to the Social Security Law hard-work occupations are divided into three categories. Occupations included into category I are considered to be most debilitating, and grant eligibility for retirement at the age of 45 for women, and 50 for men, based on a service/contribution period of 15/20 years respectively. All employees working in underground mines and most employees in metallurgy are included in category I. Occupations in category II are surface miners, metallurgy and textile workers. These occupations grant eligibility for retirement at the age of 50 for women and 55 for men, based on a service period of 20/25 years respectively. Category III includes teachers and certain medical staff. Eligibility for retirement is granted at 55 years old for women and 60--for men, based on a service period of 20/25 years respectively.

Cost-covering ratio and dependency ratio. The costs of pension benefits is a major problem for financial stability of the overall social security system. Only 64 percent of the total pension expenditures could be covered with social contributions in 1994, and this ratio would drop to 20 percent if only social contributions collected for pensions (31.7 percent) are considered. The ratios are not likely to have changed in 1995.

There are three key reasons for the low cost covering ratio:

- reduction in the number of contributors due to high unemployment and emigration;
- low participation in the social security system due to incomplete registration with the SSI and low compliance with social security obligations; and
- deteriorating age composition of the population.

The reduction in the number of contributors as a result of high unemployment and emigration has resulted in a deterioration of the ratio of pensioners to workers from 0.27 in 1991 to 0.44 in 1994. But owing to the low rate of compliance with social security contributions, the actual ratio of pensioners to contributors was 1.16 in 1994, so the number of pensioners exceeded the number of contributors.

Although the share of pensioners is increasing, Albania is still the country with the youngest population in Europe. Thus population aging poses a less immediate threat to the financial stability of the pension system, than in many other Eastern European countries.

Administration of pension benefits. Pension benefits are administered by district branches of the Social Security Institute. The benefits are paid by district SSI branches through the Savings Bank. ^{1/}

Consolidation of the SSI budget into the central government budget eliminated some problems of resource reallocation between districts. But the decentralized collection and management of the social security contributions and transfers reduced incentives for district SSI offices to enforce compliance with the social security contributions and to tighten control over the eligibility for pension benefits.

The reporting by district offices to the SSI is often late and imprecise, which restrains SSI's ability to monitor its district offices. This problem is being addressed under the Social Insurance Reform Component of the World Bank "Technical Assistance Project for Social Safety Net

^{1/} Rural pensioners often draw their benefits once in 2-3 months, because of the remoteness of district offices and poor transportation.

Development" (SSND), which includes technical assistance for establishing efficient administrative procedures between the SSI Headquarters and its district branches.

Sector specific conclusions and recommendations.

The Government did not manage to curb the growth of pension expenditures in 1995, which accounted for 6.7 percent of GDP, proving that the pension system is not financially sound in the short- or long-run. On the revenue side, the main reasons are the low participation rate in the social security system along with generally low incomes, which result in the collection of social security contributions far below expenditure needs. On the expenditure side, the pension system bears a burden of largely noncontributory farmers' pensions, partially contributory occupational pensions, early retirement and merit (state) pensions.

Enforcement of compliance with the social security contributions, especially with respect to the private sector and farmers, might improve the revenue of the SSI budget. However, the situation can not be fundamentally changed unless income levels grow faster than pension benefits, and the ratio of pensioners to contributors drops due to improved participation in the social security system. Albania cannot afford to keep increasing pension benefits at the same rate as wages since the number of recipients is growing and at the same time the number of contributors is declining. The increase in pension benefits should be limited statutorily to no more than the rate of consumer price increases.

Since farmers are not likely to improve compliance with social security contributions voluntarily, given low incomes of the farmers and the low level of their pension benefits, the Government has to either force farmers to pay social security contributions, or discontinue their eligibility, in order to reduce budgetary financing of the pension system. In the longer-run, old-age pensions for farmers should be based on the lifetime social security contributions. Those who did not contribute should not be eligible for any pension benefit. ^{1/}

In order to reduce the cost of occupational pensions during the 14-year transitional period, employees eligible for Category I occupational pensions should be offered two options, either to retire under general provisions (at 55/60 years old after 35 years of contributions), or to pay social contributions at a higher rate.

More specific short-run recommendations include the following:

^{1/} This suggestion might only improve compliance, however, if pension benefits were substantially higher than social assistance benefits.

(i) The eligibility for the disability pensions should be tightened by the introduction of a requirement for medical re-certification every six months for those with partial ability for economic activity.

(ii) The eligibility for survivor's pension benefit should be limited to dependents and those spouses which do not qualify for regular old-age pension benefits.

(iii) Two year postponement of indexation or partial indexation for new benefits might bring savings in a short-run.

(iv) The administration of non-contributory pension benefits should be separated from contributory pension benefits.

In the longer-run, the rapid growth of pension costs might be curbed by the following measures:

(i) Introduction of a strong relationship between social security contributions paid and the level of pension benefits.

(ii) Harmonization of retirement age for women with that of men by increasing the retirement age for women to 60 years old.

(iii) Extension of the retirement age to 65 years old for men and women. This measure requires a gradual approach, and should be announced far in advance. Meanwhile, incentives to postpone retirement to 65 years old should be strengthened.

(iv) The assessment base for the pension benefit should be broadened. The 3 year average wage out of the last 10 years of service, used as an assessment base now, should be replaced by a lifetime social insurance contributions as an assessment base for the pension benefit (with indexation of past earnings).

b. Maternity Benefits

Maternity benefits in Albania include a birth grant, paid maternity leave, and compensation for the loss of income due to a change of job for medical reasons. The cost of maternity benefits in 1994 was less than 5 percent of total SSI expenditures or 0.3 percent of GDP, which is of the same order as in other transition economies. ^{1/} However, Albania does not have child allowances; taking this into account, the total cost of cash benefits for children in Albania is below that in other countries of Eastern Europe.

^{1/} For example, in Russia maternity benefits were kept at about 0.2 percent of GDP, in Moldova 0.1 percent of GDP in 1993. However, family allowances in these countries accounted for an additional 0.6 and 0.5 percent of GDP respectively.

Legal framework and eligibility criteria. Maternity benefits are regulated by the Social Security Law No. 7703. They are financed out of the social security contributions. ^{1/} Twelve months of social insurance contributions is a qualifying requirement for all maternity benefits. Maternity benefits are paid to unemployed women if they contributed to the SSI for at least one year prior to becoming unemployed. Women who are unemployed, but did not contribute to the SSI for at least one year, may be eligible for social assistance, however, depending on the level of family income and assets. (See Section IV)

Compensation for the loss of income due to the change of job is paid only to women who had to change their jobs due to the detrimental health effects of the regular job that they performed before pregnancy. The medical commission is authorized to decide if the regular work of a woman was detrimental to her health, or health of her future child. A decision of the medical commission is required for this benefit.

Adequacy of the benefit, coverage and duration. The birth grant is a lump-sum payment of Leks 1500, equivalent to about 40 percent of the average 1994 monthly wage in the public sector.

Maternity leave is paid for 365 days, starting from 35 days prior to the birth of the child. The benefits are extended to 390 days for those women who delivered twins or more babies. During the first 185 days the maternity benefit is paid at the level of 80 percent of the average wage for the year prior to childbirth. For the rest of the period, the benefit is paid at the level of 50 percent of the average wage. The maternity benefit for self-employed (including farmers) and unemployed women is equal to the base old-age pension.

Compensation for the loss of income due to a job change for medical reasons is equal to the difference between the previous and present wages, but should not exceed 50 percent of the average wage received by the woman during the previous year.

In 1994, the average maternity benefit paid during the first 6 months provided a minimum level of subsistence for beneficiaries. The benefit for the second part of maternity leave did not provide the minimum subsistence level, since the benefit was lower than the base pension level. Because of the sharp reduction in the level of benefit, many women return to work before the expiration of their maternity leave.

Composition of beneficiaries In general, women with low education have more children than those with higher education, and the majority of Albanian women with little education live in rural areas. This group accounts on

^{1/} In principle, out of the total SSI contribution rate of 42.5 percent of wages, some 2.8 percentage points is dedicated to the financing of maternity benefits.

average for 6.1 children per woman. (Table 8) The overwhelming majority of well-educated women lives in urban areas. The average child/woman ratio among highly educated women is 1.7.

Even though the majority of births in Albania are in rural areas, nearly 73 percent of maternity benefits in 1993 were paid to urban recipients. 1/ This is due to two factors: (i) the large disparity in the level of urban and rural benefits described above, and (ii) much lower coverage with maternity benefits in rural areas because of the low rate of farmers' compliance with social security contributions.

Administrative arrangements. Maternity benefits are administered by employers. They finance the benefits out of a portion of social security contributions retained for this purpose (2.8 percent of the wage bill). District offices of the SSI are supposed to oversee the coverage and delivery of maternity benefits, but no information is available at the SSI headquarters on this issue.

Sector specific conclusions and recommendations. Actual spending on maternity benefits accounted in 1994 for 2.9 percent of the wage-bill as reported to the SSI, and was thus covered by contributions. But an increase in the birth rate or in the number of women who stay on maternity leave for the whole 12 months might result in a shortfall of financing for maternity benefits. A number of changes could improve the cost effectiveness of the system in the long run:

(i) Reduce the duration of maternity leave gradually from 12 months to six months. It would be helpful if this could be phased in with the development of high quality, private day care, 2/ the existence of which might motivate high income beneficiaries to return to work. For those with more modest incomes, this incentive might be reinforced by vouchers covering part of the day care costs. The reduction of maternity leave period should go along with improvements in child and women's health care. 3/

(ii) Reduce the level of benefits after the first three months of maternity leave. At present the scheme greatly reduces incentives to work, as the difference between the benefit level and the average wage is only about 20 percent for the first 6 months. Low-income women might be better-off by staying on maternity leave.

1/ Social Protection in Albania. By Alma Çiço. ILO-CEET, 1994. p.11.

2/ Public day care collapsed at the outset of the economic reform. The extended family helps to solve the problem of baby-sitting in many cases. In those families where only one member of the family is employed, the unemployed person takes care of children.

3/ Extension of maternity leave to 12 months was at least partially caused by a high incidence of infant illness, which resulted in high spending on sick leave and created disincentives for employers to hire women.

(iii) Make maternity benefits taxable. From a longer term prospective, it might be desirable to include maternity benefits into taxable income. It is easier to take this decision now, when most incomes are below the taxable threshold, rather when they become a subject to income tax.

(iv) Improve the information about the eligibility for maternity leave in rural areas. Poor means of communication between villages and district centers, lack of information and low levels of education of women in rural areas might add up to the low coverage with maternity benefits there.

c. Sickness and Work-Related Injury Benefits

Sick benefits do not pose a significant threat to financial stability of the social security system, since the Social Security Law has shifted the financing of the first 14 days of sick leave to employers. ^{1/} According to the Law, sickness benefits following the first fourteen days of illness are to be financed out of social security contributions. In 1994, SSI expenditures on sickness benefits absorbed 0.3 percent of the wage-bill as reported to the SSI, or 0.03 percent of GDP.

The financing of compensation following work-related injuries does not impose any financial burden on the SSI budget, since the employer is fully responsible for financing and administering these benefits.

Legal framework and eligibility criteria. Those sick benefits which are financed out of social security contributions are regulated by the Social Security Law No. 7703. These are paid by the SSI for sick leave beginning from the 15th day, plus compensation for any loss of income due to a job change required by a medical condition. Self-employed persons and farmers are not eligible for sickness benefits under the social security system.

Paid sick leave is granted only in cases of temporary disability which is not work-related. In order to qualify for the paid sick leave, the temporary disability has to be medically verified. Eligibility for sick benefits does not depend on prior social security contributions. However, the level of benefit depends on the period of social security contributions. The person remains eligible for sick benefits during the first 30 days after the social security coverage has expired (for example, if they leave their jobs).

The benefits for work-related injuries are regulated by the Social Security Law No. 7703, and include an allowance for health care and rehabilitation, compensation for the loss of capacity to work, compensation

^{1/} The rate of social security contributions was adjusted downwards commensurately.

for reasonable damages, and benefits in case of death. The eligibility for the work-related injury benefits does not require any prior social security contribution period.

Adequacy of benefits, coverage and duration. The sick benefit is set at the rate of 70 percent of the average monthly wage for the last year, if the period of social security contributions is up to 10 years; 80 percent if the period of social security contributions is more than 10 years. In case of hospitalization the rate of sick pay is reduced to 50 percent of the average wage since hospital care is free of charge. 1/

Paid sick leave is financed from social security contributions beginning on the 15th day of leave, and may continue for up to 6 months. It might be extended for another 3 months upon the recommendation of the medical commission. But if an employee uses a 3-month extension of paid sick leave, they forfeit eligibility for a disability pension afterwards. Paid sick leave is limited to 3 months for those who draw a partial disability pension. Temporary and seasonal workers on contracts of 3-12 months are eligible for paid sick leave of up to 75 days.

Compensation of income loss due to a job change for medical reasons is paid at the rate of 50 percent of the employee's average monthly wage for the last year. The compensation is to be paid no longer than for three months after the capacity to work has been lost.

Temporary work-related injury benefit is set at 100 percent of the employee's average wage for the last three years, and may be paid for up to 12 months.

A worker unable to resume duties after 12 months is eligible for permanent work-related injury compensation. The level of benefit depends on the degree of working capacity lost. The payment ceiling for the full benefit is 80 percent of the employee's average wage for the last three years. The benefit should not fall below the subsistence minimum level. The eligibility for partial permanent work-injury benefit requires loss of at least 33 percent of working ability. The benefit is set as a percentage of the full permanent work-injury benefit. A minor permanent work-injury benefit is granted if the loss of working capacity is between 10 and 33 percent; it is a lump-sum payment, equal to the base pension.

(3) Administrative arrangements. Administrative responsibilities for sick benefits are split between employers and the SSI. Employers are in charge of the financing and delivery of paid sick leave during the first 14

1/ Evaluation of the adequacy of actual benefits and coverage is complicated by the fact that paid sick leave is administered by employers for the first fourteen days, and they do not report to the SSI.

days. 1/ Paid sick leave for more than 14 days and compensation for the loss of income due to a medically necessary job change are administered by the Social Security Institute through its district branches, and financed out of a portion of the social security contributions (1.5 percent of the wage-bill) designated for this purpose.

The Social Security Law does not give the SSI any responsibility to supervise the portion of sick benefits administered by employers. Thus, no information on costs, the number of recipients, or average duration of benefits are available from the SSI. In addition, since the costs of sick benefits comprise just a small portion of SSI expenditures (0.5 percent), the Headquarters of the Social Security Institute does not closely oversee the activity of its district offices in this area.

Sector specific conclusions and recommendations.

Although sick benefits do not impose a large burden on the SSI budget, employers' costs for the first 14 days of sick leave might be considerable. Personal income growth could quickly raise the cost of paid sick leave borne by employers. 2/ In order to tighten the eligibility of sick benefits and reduce the costs borne by employers, it might be desirable to switch the responsibility for the first 3-5 days of the sick leave from employer to employee.

In the longer run, shared employer/employee responsibility for the financing of sick benefits should be extended to the full duration of temporary sick leave, thus phasing out entirely SSI financing of sick benefits. The duration of sick leave should also be gradually reduced from 6 months to 3 months, then later to 1 month, with the development of the health insurance system.

d. Unemployment Compensation

Unemployment insurance in Albania was introduced in 1992, as part of the effort to ensure the sustainability of the economic adjustment effort following the virtual collapse of the state enterprise system. During 1992, employment dropped by 50% as a result of massive layoffs at the state-owned enterprises and budgetary institutions. Open unemployment became a major social and economic issue almost overnight. While unemployment has declined significantly with the subsequent economic recovery, a large and growing

1/ The sick pay for the first 14 days is regulated by employment contract and Labor Code, but not to be below the level defined by the Social Security Law for the sick leave financed out of the social security contributions.

2/ Growth of sick leave costs increases labor costs for employers, thus reducing labor demand and implicitly contributing to unemployment.

cadre of long-term unemployed (over 12 months) emerged. In addition, the lack of jobs in Albania led to a surge of emigration to neighboring countries, especially Greece and Italy, accounting for an estimated 15% of the labor force.

Labor hoarding, estimated at more than 14 percent of total employment in 1990, increased even further by mid-1991 as production in various sectors virtually stopped. Inactive workers were entitled to the payment of 80% of their wages for an unlimited period of time. These payments to the idle workers comprised more than 55% of the total subsidy to enterprises, or 10% of GDP, in 1991. This arrangement was superseded by a system of unemployment insurance beginning in July 1992.

The unemployment rate has declined from a peak of 34 percent of the domestic labor force in April 1993, to 19 percent as of end 1994, and 14 percent as of September 1995. (Table 9). The number of unemployed receiving benefits declined much faster than total registered unemployment. The declining unemployment trend was temporarily halted in the fourth quarter of 1994 as a result of introduction of one year severance pay for redundant employees of some of the ERA (Enterprise Restructuring Agency) and the Ministry of Mining and Energy enterprises. 1/

The decline of unemployment benefit recipients resulted in a reduction of unemployment costs from 4.2 percent of GDP in 1993 to 1.4 in 1994, and was expected to be 1.2 percent in 1995. Unemployment benefits have not been raised since February 1994, which allowed unemployment expenditures to drop to 1.2 percent of GDP in the first half of 1995.

Legal framework and eligibility criteria. Unemployment insurance is regulated by the Social Insurance Law No.7703, enacted on May 11, 1993. Eligibility for severance pay is regulated by Decision of the Council of Ministers No. 420 "On the Severance Pay of Redundant Employees" of August 15, 1994.

The eligibility criteria for unemployment insurance include at least one year of social security contributions, 2/ registration at the local labor office, and the requirement not to be involved in any economic activity. Although willingness to participate in training/retraining programs is included in the eligibility requirements, there is not presently any screening on this basis. Applications may be rejected if the unemployment resulted from a dismissal which was voluntary, or was due to misconduct.

1/ Although severance pay is not part of social insurance, it was used as a substitute for unemployment benefits in the case of mass lay-offs of workers from politically sensitive enterprises. New entitlements for severance pay were discontinued in August 1995.

2/ The Law does not specify if one year of insurance is enough to qualify for unemployment benefits several times during the service period.

Eligibility for severance pay requires at least two years of service at an enterprise prior to its closure. The benefit is supposed to be conditioned on participation in public work projects.

Adequacy of benefits, coverage and duration. The Social Security Law introduced a flat rate unemployment benefit from October 1, 1993. According to the Law, the level of unemployment benefit is to be annually defined by the Council of Ministers. In practice it was set equal to the base pension in 1994; however, in 1995 the level of unemployment benefit was left unchanged when the base pension was increased. Eligibility is limited to twelve months; thereafter anyone still unemployed may be eligible to receive social assistance (see Section IV).

The use of a flat rate benefit related to the minimum subsistence level is intended to make unemployment benefits adequate to cover the costs of essential goods, while minimizing disincentive effects. The benefit is supplemented by dependent and energy compensation which amount to 38 percent of the total benefit (see Section V). Dependent compensation is adjusted according to the number of dependents in a family, which improves the targeting of the overall benefits received by the unemployed.

The income replacement ratio (ratio of the average unemployment benefit to the average wage in the public sector), which was less than 50 percent in 1993, rose to 61 percent in 1994. The income replacement ratio was expected to increase to 68 percent in 1995, due to the introduction of severance pay for many public enterprise employees; the income replacement ratio for unemployment benefits alone was expected to decline to 56 percent. Many unemployment recipients are able to supplement these benefits due to widespread opportunities for part-time and informal employment in the private sector, and the lack of control by the labor offices. Such opportunities reduce the incentives for the unemployed to search for a permanent replacement job.

Severance pay is equal to an employee's average wage during the twelve months before becoming redundant. In the first half of 1995, average severance pay was 9 percent higher than the average wage in the public sector, 1/ and 79 percent higher than the unemployment insurance benefit. In addition to their base wages, the recipients of severance pay also received all cash wage supplements to which they were entitled before becoming redundant, along with compensations which were not paid by many enterprises because of their poor financial situation. Severance pay significantly reduces incentives for its recipients to search for a replacement job in several ways: it is paid monthly rather than as a lump-sum; it is discontinued if the recipient finds other work; and recipients are eligible for a full year of unemployment benefits once the severance payments are exhausted.

1/ Miners with higher than average wages comprised the majority of severance pay recipients.

Coverage of benefits. The principle of widespread entitlement to unemployment benefits and easy access to labor offices in urban areas assures a high level of coverage with unemployment benefits. The list of beneficiaries for severance pay is prepared at the enterprise level and transferred to the local labor office for payment of the benefit. Local labor offices do not screen applications further.

Unemployment duration. The declining share of benefit recipients in the total number of unemployed, from 79 percent in November 1992 to about 20 percent in late 1994-95, suggests that the number of the long term unemployed (more than 12 months) has increased. 1/ Only 21,600 people, or about 8.2 percent of the average number of unemployed, returned to work in 1994. 2/ According to the Ministry of Labor, approximately one of every four unemployed is becoming eligible for social assistance once their unemployment benefit ends after twelve months (Chart 3).

Following the distribution of agricultural land, the incidence of unemployment in rural areas became much lower than in cities. Thus, in 1994 the unemployment rate among non-agricultural workers was 27.5 percent, while in rural areas it accounted for just 8.6 percent. However, many of those now working on family farms are likely to be underemployed and potential migrants to the urban labor force.

Composition of beneficiaries

Gender breakdown. Unemployed women accounted for 47 percent of total unemployment in 1994, and this ratio has declined to 44 percent in the third quarter of 1995. This is a relatively low rate of unemployment among women compared with other Eastern European countries. 3/ At the same time, the participation rate of women in the labor force seems to be declining, as in other transition economies: women comprised only 41 percent of the registered unemployed who returned to work in 1994.

Regional unemployment. Unemployment is concentrated in big cities and former locations of large state enterprises, such that four out of the country's 36 districts account for more than 40 percent of the total number of unemployed: Tirana (18.5% of the nation's unemployment), Elbasan (10.4%), Shkoder (6.4%) and Berat (5.6%). Northeast and Mountain regions account for another 16 percent of the country's unemployment. Although unemployment rate in remote Tropoje has declined from nearly half of the labor force in the first half of 1995, it is still much higher than average for the economy at 26 percent. (Table 10). 4/

1/ No explicit data are available on the duration of unemployment.

2/ According to data from the Ministry of Labor and the staff estimates.

3/ Female participation rate in the labor force in Albania is about the same as in other Eastern European countries.

4/ These rates are based on the national labor force (including emigrants).

Unemployment by age. The available data do not provide a detailed breakdown of unemployment by age. Since new entrants to the labor force are not eligible for unemployment benefits, most of them do not register as unemployed. 1/ The group of unemployed under age 20 accounts for about 15 percent of the total number of unemployed. The unemployment rate within this age group is close to the average for the economy.

To some extent unemployment among people under 20 years old reflects the slow adjustment of the education system to the needs of a market economy. Reportedly the curricula at schools have not been revised since the beginning of the reform. Teachers need retraining and new teaching aids (e.g. books) to be able to provide skills demanded by the market. Reform of the education system has not yet started, but is urgently needed to avoid a high rate of core unemployment in the future.

Education level of the unemployed. The educational structure of unemployment shows that low skilled and less educated people are the first to lose jobs. The unemployment among those with higher education is significantly lower than of those with primary or secondary education. 2/ In the first half of 1995, only 3 percent of the unemployed were reported by the Ministry of Labor to have a higher education. The distribution of land led to a one-time decline in the share of the unemployed with education under 8 grades, from about 54 percent in 1993 to 47 percent in 1994, and a corresponding increase in the share of unemployed with a secondary education. In 1995 the composition of unemployment by education remained unchanged.

Before 1992, vocational training in Albania was less developed than in other Eastern European countries. 3/ The Ministry of Labor started to introduce adult training programs in 1993 with the assistance of the World Bank and international NGOs. Such financing of training/retraining is on a small scale, however; these programs accounted for less than 0.3 percent of total expenditures on unemployment in 1993, and in 1994 this share only increased to 2.8 percent. Training/retraining programs do not appear to have had a significant impact on reducing unemployment so far. The main reason is that the Ministry of Labor has little information on labor market demand. Most of the programs are pilot projects and, as they are costly, there is little chance that they would be replicated on a larger scale.

As in other Eastern European countries, serious housing shortages and inadequate transportation have severely hampered labor mobility. This has

1/ Only 0.1 percent of the unemployed claim that they are looking for their first job.

2/ Estimates of unemployment rate by education level cannot be made since information on distribution of the labor force by education is not available.

3/ No information about the incidence of unemployment among the graduates of vocational schools is available.

slowed the reduction in unemployment which might otherwise have been possible thanks to rapid economic growth during the past few years.

Administrative arrangements. Unemployment insurance is administered by local labor offices, under the authority of the Ministry of Labor. The ratio of unemployed/labor-officers was 225/1 in 1994, which is high by international standards. However, an increase in the staff of the Ministry of Labor and its district offices is probably not necessary, given the anticipated continued decline in unemployment in the coming years.

The activities of district labor offices are limited to registration, verification of eligibility, and payment of benefits. There is no effort to check whether a recipient has another job, except that the unemployed person has to visit the labor office once a month. Control has been complicated by the abolition of the requirement that a person has to submit a work book to get a job.

Financing of unemployment insurance. The Social Security Law defines unemployment compensation as a contributory benefit. Notwithstanding this provision, financing of unemployment benefits has been assumed entirely by the budget, and payroll contributions related to unemployment insurance were co-opted into the overall social security contributions. Financing unemployment benefits out of the budget was important for the timeliness of delivery and full coverage, but this left little incentive for the Ministry of Labor and the Social Security Institute to improve collection of social contributions or administration of cash benefits. Given the declining cost of unemployment benefits, the Ministry of Finance does not monitor closely how the funds are utilized.

Budgetary expenditures for unemployment benefits dropped from 4.2 percent of GDP in 1993 to 1.4 percent in 1994, and to 1.2 percent in the first half of 1995. This reduction occurred mainly due to a decline in the number of beneficiaries, a result of completion of land distribution, as well as better administration of unemployment benefits after the introduction of the Social Security Law. The costs of unemployment benefits decreased faster than the number of unemployed eligible for benefits, suggesting that the entitlement for the benefit has been tightened and that the level of benefits has declined in real terms.

Sector specific conclusions and recommendations.

The introduction of unemployment insurance in 1992 was critical to the sustainability of the stabilization effort. In particular, by providing income support directly from the budget, unemployment insurance greatly reduced labor hoarding at the state enterprises and facilitated the closure of non-viable enterprises.

The structure of unemployment has changed considerably since 1992. By end-1994, unemployment in rural areas had dropped by 68 percent, while the number of unemployed in the cities had declined by only 15 percent. Long-

term unemployment increased from an estimated 7 percent of the domestic labor force in December 1992 to 15.5 percent in December 1994.

The decline in the number of unemployed in rural areas is somewhat misleading, since the farms are generally small and provide only the minimum subsistence level of income. Migration from rural to urban areas might intensify shortly, further increasing the number of unemployed in the cities.

Structural reforms along with further stabilization efforts and high rates of economic growth would allow an expansion of domestic investment and attract international investors. But in the short-run, the relatively high level of unemployment is likely to persist, along with a growing core of long-term unemployment.

Although the costs of unemployment benefits declined in 1994, they are still burdensome for the central budget. In the longer run, unemployment insurance should be financed out of social security contributions as prescribed by the Law. Enforcing this provision should increase the responsibility of the SSI for their collection, and of the Ministry of Labor for their administration. This might give even better results if the pilot "one stop shop" project were replicated across the country. 1/

The implementation of Decision No. 420 granting severance pay slowed down the decline in unemployment expenditures in 1995. The costs of unemployment benefits are unlikely to decline in 1996 since those who received severance pay in 1995 remain eligible for the unemployment insurance benefit. Moreover, the high level of severance pay, with the subsequent availability of unemployment compensation, greatly reduces the incentives for job search during the first 12 months. This could be mitigated if severance pay were a lump-sum benefit, which would provide the beneficiary with the opportunity to invest, for example, in a small private business.

The Social Security Law should be amended in order to specify qualifying requirements for repeated unemployment benefits. These might include a requirement for at least 24 months period of social security contributions between the enforced redundancies. The level of the unemployment benefit might also be differentiated depending on whether a recipient had drawn unemployment benefits before.

For the period of registered unemployment, temporary booklets confirming the period of social security contributions should be deposited at the local labor office.

1/ The World Bank has suggested developing "one stop shops"--an Irish model of combined labor and social insurance offices--as a sub-component of the "Technical assistance Project for Social Safety Net Development".

Two structural measures are also needed to avert high levels of core unemployment in the future. First, the education system must be reformed to equip young people entering the job market with the skills required in a market economy. Second, legal and administrative barriers to labor mobility must be removed. The most important step in this regard is to clarify private property rights, so that private construction can begin to redress the serious housing shortage.

IV. Social Assistance

Social Assistance was designed to provide income support for households with little or no income. It is financed directly from the central budget. Initially the costs of the system were boosted by a sharp increase in the number of beneficiaries and a lack of administrative capacity. The situation started to improve in 1995, however, with the tightening of block grants for social assistance financing allocated to municipalities and communes. There has also been some improvement in targeting as a result of efforts by the inspectors of the Ministry of Labor to monitor the implementation of the Social Assistance Law.

Social assistance expenditures declined from 2.4 percent of GDP in 1994 to an estimated 1.8 percent in 1995. They are still burdensome for the central budget, however, accounting for 6.3 percent of current budgetary expenditures. The cost of social assistance could be further reduced, through better targeting and better administration of benefits.

Legal framework and eligibility criteria. Social assistance was first implemented under a Directive of the Ministry of Finance of May 9, 1992. The Social Assistance Law No. 7710, which has provided a legal framework for social assistance, was approved in May 1993.

The Law introduced the system of full and partial social assistance benefits, defined the eligibility criteria, and delineated the size of benefits. Full social assistance is granted to households without any other source of income. Partial social assistance may be provided to families with per capita incomes below the subsistence minimum level. 1/ Large households (six or more members) may be entitled to partial social assistance regardless of income, if it does not result in reallocation of resources from the poorest households. 2/

1/ Incomes are considered to be below the subsistence minimum level if they are less than the base pension.

2/ This provision is not likely to result in leakages at the moment since the overwhelming majority of large families are poor. However, the lack of means testing might lead to problems with further income differentiation of households.

The Law requires that recipients of social assistance benefits report monthly to the Council of the municipality or commune on their financial situation. Economically active individuals also must provide a labor office certificate confirming the absence of job opportunities. These provisions have not been implemented strictly at the local level, and thus there is considerable scope to improve targeting.

Adequacy of the benefit level, duration and coverage. According to the Law the level of the social benefit is at the discretion of the Council of Ministers. Decree No.328 of June 30, 1993 defined the social assistance benefit to be dependent on the size of the household. The level of the social assistance benefit is linked to the unemployment benefit, and hence the base pension.

The full social assistance benefit for a two-person household has been set at a level equivalent to 140 percent of a single person's unemployment benefit. Recipients of social assistance benefits have also been eligible for dependent and energy compensations. The Social Assistance Law does not specify a maximum duration of the benefit.

Estimation of the adequacy of social assistance benefits is complicated by unreliable statistics on the number of recipients provided by municipalities and communes to the Ministry of Labor. Approximately 8 percent of all municipalities and communes do not submit their reports.

In its initial stages of implementation, the Social Assistance Law resulted in excessive costs due to poor targeting and lack of means-testing. According to World Bank estimates, roughly 95 percent of those who applied were granted the social assistance benefit during 1993. All eligible applicants received social assistance benefits at the maximum level, because local authorities administering the program did not face financing constraints. Thus, the cost of social assistance benefits increased from 0.5 percent of GDP in 1992 to 2.8 percent by the second half of 1994.

The size of the social assistance benefit in 1993-94 was adequate to the subsistence minimum, after taking into account economies of scale (since it is a household-based benefit) and also the eligibility of social assistance recipients for price, dependent, and energy compensation. However, in 1995 the level of benefits declined in nominal terms since energy compensation was discontinued from January 1995.

In order to impose a ceiling on the total budgetary cost of social assistance and improve incentives for better targeting of benefits, a system of block grants was introduced under the Social Assistance Law of July 1993. The system of block grants came in effect in July 1994. Municipalities and communes were allocated a fixed nominal amount as described below (see (4) Administrative arrangements). It was intended that improved targeting would result in greater differentiation in benefits among families, and a significant decline in the number of beneficiaries. The introduction of block grants was supplemented with the reduction of the minimum full social

assistance benefit granted to the two-member household from 140 to 100 percent of a single person unemployment benefit. However, in 1994 the system of block grants did not reduce the costs of social assistance, which increased from 1.2 percent of GDP in 1993 to 2.4 percent in 1994. ^{1/} The main reasons for the growth of social assistance expenditures were an increase of the benefit by 38 percent on average in January 1994, the introduction of energy compensation in April 1994, which amounted to 22.3 percent of the minimum benefit, and poor targeting. These factors more than offset the reduction in the number of full social assistance recipients in rural areas and the introduction of block grants.

The costs of social assistance were reduced to 1.8 percent of GDP in the first nine months of 1995, which mainly resulted from somewhat improved targeting due to the elimination of energy compensation, and to efforts made by the Ministry of Labor inspectors installed in Prefectures to better monitor the implementation of the Social Assistance Law.

The reduction of social assistance expenditures in January-May 1995 ^{2/} was done at the expense of large urban families (Table 11). The average level of social assistance benefit for households with six and more members started to decline beginning from January 1995, which might indicate some improvement in means-testing.

Composition of beneficiaries. The number of social assistance recipients exceeded 17 percent of the total population by 1994, and has remained broadly unchanged since that time (Table 12). ^{3/} However, the composition of the recipients changed significantly in 1993-94. The number of rural recipients of full social assistance dropped from more than 9 percent of population in the second half of 1993 to less than 1.0 percent in the second half of 1994, as a result of the distribution of agricultural land. However, the total number of social assistance recipients did not decline, since a majority of those who received land continued to be eligible for partial social assistance because of the small size of farms. The average farm in Albania does not exceed 1.12 hectares; about 48 percent of the farms are below this average. This explains the high cost of the partial social assistance benefit (about 40 percent of the total) (Table 13), which is not likely to decline significantly in the short-run. The number of urban recipients of full social assistance is gradually

^{1/} Implementation of the Social Assistance Law in July 1993 resulted in a substantial increase in social assistance costs since the eligibility for social assistance was extended to all low-income rural families, whereas the old law provided benefits only to the families located in the north-east mountainous areas with less than 0.2 hectares per person.

^{2/} Detailed data on social assistance are available only through May 1995.

^{3/} This is an estimated number, since social assistance benefits are paid to households rather than individuals.

increasing due to the expiration of unemployment benefits. 1/ Illegal migrants to the cities also increase the number of poor who receive social assistance benefits in urban areas. However, the number of urban recipients of the partial social assistance has declined due to significant real increases in pension benefits. 2/

Regional disparities in the social assistance. According to INSTAT estimates, as of end 1994 more than 48 percent of the social assistance recipients were located in the impoverished and mountainous north-eastern regions. These regions accounted for less than 27 percent of the population according to the 1989 census. There is also a relatively high concentration of social assistance recipients in the former industrial centers of Berat and Elbasan due mainly to the high incidence of long-term unemployment.

The level of benefits across regions varies in the range of 70-130 percent of the average benefit. These differences are attributed to regional discrepancies in the composition of beneficiaries--e.g. number of families on full and partial assistance, number of dependents, but may also reflect the bargaining power of some of the local authorities with the Ministry of Labor.

Administrative arrangements. Social assistance benefits are administered at the local level, by municipalities and communes. Social assistance benefits are financed from the central budget through block grants. The Ministry of Labor is in charge of the allocation of block grants to municipalities and communes.

The Ministry of Labor uses indirect indicators to define the amount of block grants for municipalities and communes. Municipalities and communes submit their requests for financing to the Ministry. The Ministry analyzes these requests with respect to the total population of the municipality or commune, the number of children under 18 years old, employment, the number of unemployed, and (in rural areas) the number of small farmers. However, the results of the analysis are not very reliable due to insufficient information at the local level. The information on employment and unemployment is collected at the district level, with no breakdown for municipalities and communes. Accordingly, the Ministry of Labor allocates block grants mainly on the basis of the social assistance costs incurred by municipalities or communes in the previous year, which reduces the local authorities' incentives to better target benefits.

The Ministry of Labor expected that limiting the total financing for social assistance would force municipalities and communes to improve

1/ According to the Ministry of Labor, about 40 percent of unemployed are moving on to social assistance once their unemployment benefits expire after 12 months.

2/ Single pensioners drawing partial pensions comprise a significant number of urban partial social assistance recipients.

targeting. However, some local authorities preferred to reduce the size of the benefit rather than to cut off ineligible recipients. ^{1/}

The Ministry of Labor has installed inspectors at the prefectures to monitor the implementation of the Social Assistance Law. They reassess social assistance spending by municipalities and communes, and visit households in order to verify eligibility for the benefit. When benefits appear to be paid to a family which does not qualify, payment is terminated, the officials responsible are fined, and the amount of the local block grant is reduced by a corresponding amount.

Beginning in 1995, the Ministry of Labor does not allow social assistance benefits to be granted until there has been an inspection of an applicant's household. The application for the social assistance may be denied based on evidence of outside income, including, for example, ownership of an automobile or a color television set.

Although the Social Assistance Law specifies that local authorities are responsible for reporting on the use of block grants to the Ministry of Labor, the provision is not fully enforced. Eight percent of municipalities and communes do not submit their reports on the use of social assistance block grants.

Sector specific conclusions and recommendations. Regional disparities in economic development, the existence of pockets of extreme poverty, widespread subsistence farming and the likely persistence of high unemployment make substantial expenditures on social assistance inevitable. However, the cost efficiency of social assistance should be improved.

This is complicated by the relatively weak incentives for local authorities to target the benefits and contain overall social assistance expenditures. The most effective way to strengthen local incentives would be to transfer responsibility for financing at least partially to local budgets. This is only feasible in the long-run, however, given the present underdevelopment of the fiscal system at the local level, as well as regional disparities in economic development.

Setting cost efficiency targets for reductions in social assistance financing from the budget over the next 3-5 years could help to increase further the incentives for better targeting the benefit to the most needy households. The reduction of block grants should depend on the expected level of regional economic development and demographic structure. Local authorities should begin to take responsibility for financing any social assistance expenditures in excess of the allocated block grant.

^{1/} Beginning from January 1995 the requirement for social assistance benefit to be not less than 50 percent of a single person unemployment benefit was eliminated.

These are also a number of measures which should be taken in the short-run to improve the current system of financing and administration of social assistance benefits:

(i) Administrative Improvements:

-- the reporting by local authorities to the Ministry of Labor on the use of block grants should be enforced. The transfer of the block grant should be made conditional on submission of a report for the previous period;

-- improvements in the targeting of social assistance are most important for the group of economically active individuals. In order to reduce abuse of the social assistance, enrollment for the benefit could be conditional on participation in public works projects for recipients in economically active age who are not ill or handicapped. It is also important to tighten control over the eligibility for social assistance benefits for households of economically active individuals. Control over the eligibility would become easier with the introduction of personal identification social security numbers;

-- the groups of single pensioners with low pension benefits and handicapped persons do not change quickly over time, and thus require less control over eligibility for the social assistance benefit.

(ii) Defining the level of benefits:

-- The purpose of the social assistance benefit is to provide for a minimum level of basic support for Albania's poorest residents. Thus, the size of the benefit should be set with respect to the needs of specific households, taking into account the number of dependents.

-- The level of benefit will need to take into account significant changes in the minimum subsistence level of income, although here, too, formal indexation should be avoided;

-- The efficiency of block grants might be significantly improved if the Ministry of Labor had more information on the incidence of poverty across the country. Thus, the national poverty assessment and household survey which are to be carried out with the assistance of the World Bank are of great importance for better targeting of social assistance benefits;

-- In the meantime, allocation of the block grants should take into account regional disparities in the living costs. Geographical location could also be used as an indirect indicator of regional living standards;

-- The provision of partial social assistance in rural areas is considered as a permanent government income support to small farmers with poor quality land. To complement this approach there should be a review of the possibilities for consolidating such farms to improve their productivity.

V. Price Subsidies and Compensation

An important, temporary feature of the Albanian social safety net has been the provision of budgetary transfers to households following the elimination of price controls and subsidies, in order to cushion the impact

and help maintain the consensus in favor of economic reform. There have been three major rounds of compensation: (i) food price compensation, in conjunction with the August 1992 decontrol of most consumer goods prices, including all food other than bread; (ii) bread price compensation, introduced when bread prices were raised to cost-covering levels in July 1993; and (iii) energy price compensation, introduced in April 1994 in conjunction with a sharp increase in electricity prices. (Table 14).

Price compensation is financed from the central budget. Employers administer the benefit on behalf of their employees, while the Social Security Institute and local labor offices administer the program for pensioners and recipients of unemployment and social assistance.

Price reform in Albania

Until mid-1990, all retail and wholesale prices in Albania were fixed by the government and had remained unchanged for more than three decades. In order to stimulate domestic food production, in July 1990 the Government authorized the sale of fruits and vegetables in parallel markets at freely negotiated prices. No further pricing reforms were introduced until mid-1991, around the time of the collapse of the last communist government. During the second half of 1991, some additional consumer goods prices were decontrolled, and large adjustments were made to some controlled consumer prices, mainly for energy products. Official wholesale prices, by contrast, were adjusted on a number of occasions during the second half of 1991 and by large amounts, resulting in an increase in budgetary price subsidies (paid directly to producers).

In August 1992, the Government eliminated price controls for all items other than essential and monopoly-controlled goods (roughly 25 percent of the urban household consumption basket). At the same time, it raised the prices of most controlled products by large amounts to limit the cost of budgetary subsidies. The CPI rose by 47 percent during August, but by November 1992 inflation had subsided to single-digit monthly rates.

In July 1993, the price of bread--Albania's staple food--was doubled, bringing the price to the cost recovery level. Subsequently bread prices came under downward pressure owing to the entry of private bakers and the availability of low-cost imported flour. As a result, bread prices were partially liberalized (a ceiling price was maintained). Prices of other subsidized goods were also increased over the course of 1993, bringing them closer to their cost-recovery levels.

In the last major wave of price reform, in April 1994 the prices of heating fuels were liberalized and the consumer price of electricity was raised by more than 300 percent. Following these measures, prices that had

either been decontrolled or raised to cost-covering levels accounted in 1994 for about 93 percent of the consumption basket. 1/

Price decontrol has been a major factor in the strong growth of output in the agricultural and services sectors in 1993-95. In addition, these measures reduced the budgetary cost of price subsidies from 3.6 percent of GDP in 1992 to 0.5 percent of GDP in the first half of 1995.

Design and implementation of price compensation

Food price compensation was introduced in August 1992 in partial compensation for the price increases of five basic items (bread, rice, vegetable oil, sugar, and soap). The compensation was calculated on the basis of average per capita consumption, and set at 280 leks per month (about 11 percent of the average wage in the economy, and 40 percent of the average urban pension). Additional compensation of 200 leks per month was granted for each dependent.

Eligibility for this compensation was limited to public sector employees, recipients of government transfers, and rural families with land holdings of less than 0.2 hectares per person in the northeastern parts of the country. Rural pensioners were excluded because of farmers' low compliance with social security contributions.

Bread compensation was introduced in August 1993 after the price of bread was raised to its cost-recovery level. The compensation was set at 219 leks per month, which was intended to cover 100 percent of the estimated cost of the bread price increase, based on monthly per capita bread consumption of 17.5 kg per person.

Bread compensation was provided to the same groups as food compensation, but also included poor farmers outside the northeastern region. However, certain groups of recipients were entitled only to a lower level of compensation. Thus, state enterprise workers were eligible for compensation of 75 percent of the compensable consumption level, and the compensation for this group was to be discontinued in 1994. 2/ The compensation for the state farm employees was set initially at 70 percent of the compensable consumption level, reduced to 30 percent by March 1994, and eliminated in July 1994. 3/

1/ This figure includes bread, whose ceiling price remained above the cost-recovery level for state bakeries, but excludes electricity. By end-1995, however, the bread ceiling had become binding for many bakeries, but the Government postponed any increase until after the 1996 general election.

2/ In practice, compensation for state enterprise workers was further reduced in the first half of 1994, and eliminated from July 1994.

3/ Despite these initial provisions, bread compensation was paid at 100 percent of the compensable consumption level for both state-enterprise and state-farm workers during the period of eligibility.

Food and bread compensation accounted for more than 13 percent of the 1993 average wage in the public sector, and about 39 percent of the average urban pension benefit. Food and bread compensation were discontinued in January 1994 (July 1994 for state enterprise and state farm employees). For the budgetary employees and recipients of the government transfers, both compensations were consolidated into their base incomes. Dependent compensation for pensioners, unemployment benefit and social assistance recipients remained unchanged.

Energy compensation was introduced in April 1994 in order to partially reimburse about 75 percent of the additional costs borne by households due to the increase of energy prices. Decree No. 138 as of March 31, 1994 "On the Compensation for the Change in Prices of Fuel and Energy" outlined eligibility and levels of the compensation (Table 15). Average monthly compensation was set at 350 leks per dwelling. 1/

A second (temporary) energy compensation was introduced in November 1994 to cover additional energy costs during the winter 1994-95. The benefit was set at 150 leks per month, and was discontinued in April 1995. Initially it was intended only for 550,000 low-income budgetary employees and poor pensioners. In practice, however, it was provided to all other urban recipients of the original energy compensation (except for state enterprise employees), and to recipients of partial social assistance, bringing the actual number of temporary energy compensation recipients to about 600,000.

The budgetary cost.

Although the compensations were supposed to provide temporary compensation for the costs of food and energy price increases, most of the compensations became a permanent part of incomes. The food and bread compensations were consolidated into the base wage of budgetary employees and into pensions in January 1994. Energy compensation in turn was consolidated into the base wage of public sector employees in May 1995. While the compensations were eliminated, this raised the effective cost to the budget since budgetary employees receive bonuses (e.g. for length of service and supervisory positions) as a percentage of their base wage.

1/ Electricity theft is a widespread problem in Albania. The Government did not want to provide a pure transfer to the households which do not pay for the electricity consumption. Therefore, there was also a requirement that consumers show proof of a valid contract with the state electricity company, KESH, in order to receive the compensation. But this provision was never enforced.

Compensation costs also escalated because, as noted above, in most cases their implementation resulted either in a higher level of benefits than was initially envisaged, or extension of compensation to initially excluded groups.

The failure to monitor either eligibility for compensation, or the utilization of funds transferred by the budget to administrators, almost certainly led to large leakages. For example, no precise information is available about whether price compensation was paid to state-enterprise workers. Ministry of Labor specialists generally believe that only solvent enterprises paid compensation. There also appears to have been over-reporting of the number of eligible employees and their dependents by line Ministries. Lack of verification of eligibility for dependent compensation is probably one of the main reasons for the surging number of dependents reported by employers. In 1993-94, only 70 percent of employees of budgetary institutions claimed to have dependents, but according to the Budget Department of the Ministry of Finance this figure increased to about 1.1 dependent per employee in 1995.

The cost of energy compensation was increased by the provision that families with only one employed person were eligible for energy compensation 100 percent higher than the regular amount (700 leks/month). In the absence of any monitoring or verification, the number of claimants for this compensation grew rapidly, and reached in the first quarter of 1995 about 25 percent of the total number of energy compensation recipients in budgetary institutions. This provided an additional wage increase to the recipients when the compensation was consolidated into the base wage in May 1995.

Conclusions

Food and energy price compensation provided income support during the period of price liberalization, and it allowed the Government to move faster in price reform than in many other countries in transition.

Food, bread and energy compensation also had a permanent impact on the incomes of recipients, as they were consolidated into base incomes at the time budgetary transfers were discontinued. Consolidation of the compensations was most important for the budgetary employees, since their seniority supplements and bonuses were set as a percent of the base wage.

Given the rather small number of prices remaining to be liberalized or raised to cost-covering levels, there does not appear to be a clear rationale for any further rounds of price compensation.

VI. Conclusion

The social safety net system in Albania has played an important role during the initial period of transition supporting the poorest groups of population with income transfers, and in administering social security benefits. The introduction of a new legal framework for the social security system led to some improvement in the efficiency of the system. However, the expenditures of the social safety net system remain high at more than 11 percent of GDP in 1994, and they impose a significant burden on the central budget (7.7 percent of GDP in 1994, and an estimated 6.4 percent in 1995).

It is unlikely that the financing demands on the social safety net would diminish in the short- and medium-term since widespread poverty and high levels of unemployment are likely to persist over the next few years. Therefore it is vital that measures be taken in the short-run to contain the total cost of the social safety net while protecting the truly needy. It is also important to take steps now to ensure that in the long-run Albania will have a financially stable social safety net appropriate to a market economy.

Improved compliance with the social security contributions, especially on the part of the private sector (urban and rural), is extremely important to the financial stability of the SSI given limited additional sources of the social safety net financing. Reviewing the completeness of employee registration with the Social Security Institute can broaden the tax base. The introduction of personal identification social security numbers would allow the SSI to improve control over the compliance with social security contributions. The level of benefits should be made dependent on the amount of social security contributions paid in order to enhance incentives for better compliance. The administration and financing of contributory benefits should be separated from non-contributory benefits.

Improved targeting of social assistance benefits is important for restraining the growth of social assistance expenditures as well as for ensuring the provision of an adequate level of benefits to the truly needy. Completion of the poverty assessment and the household survey with the assistance of the World Bank would provide the Ministry of Labor and the local authorities with additional information needed for better targeting of social assistance benefits. Targeting could also be improved through enforcing reporting requirements at the local authorities' level, means-testing and through the introduction of public works programs as a qualifying requirement for individuals of economically active age to receive social assistance benefit.

Table 1. Albania: Financing of the Social Safety Net

(in percent of GDP)

	1992	1993	1994	1995 (est.)
Expenditures	<u>11.2</u>	<u>13.2</u>	<u>11.4</u>	<u>10.7</u>
Social Security Institute	6.6	6.4	6.3	7.1
Pensions	6.6	6.1	5.4	6.7
Maternity and sickness benefits	...	0.2	0.3	0.3
Other	...	0.1	0.6	0.1
Unemployment compensation	3.2	4.2	1.4	1.2
Social Assistance <u>1/</u>	0.5	1.2	2.4	1.8
Price compensation for employed persons	0.9 <u>2/</u>	1.4	1.3	0.6 <u>5/</u>
Revenues	<u>11.2</u>	<u>13.2</u>	<u>11.4</u>	<u>10.7</u>
Social Security contributions	3.4	2.8	3.7	4.3
Budgetary financing <u>3/</u>	7.8	10.4	7.7	6.4
<hr/>				
Memo items:				
Price subsidies to enterprises	4.1	2.2	1.2	0.6
Total compensation for price increases <u>4/</u>	3.9 <u>2/</u>	7.5	3.8	2.5 <u>5/</u>

Source: The Social Security Institute, the Ministry of Finance and staff estimates.

1/ Does not include payments to "idle workers" in 1992.

2/ Beginning from August 1992.

3/ Does not include payment of social security contributions for employees of budgetary institutions (about one-half of total social security contributions).

4/ Price compensation for transfer recipients (subsumed under pensions, unemployment benefits, and targeted poverty programs) plus price compensation for employed persons.

5/ Energy compensation was discontinued for employed persons in May 1995; for recipients of the social assistance it was not paid from January 1995.

Table 2. Albania: The Composition of the Social Safety Net System

Components	Number of Beneficiaries end 1994, thousands	Legal Regulations	Administered by	Level of Administration	Contributory/non-contributory
Social Security	491 <u>1/</u>	Social Security Law	Social Security Institute	District	Contributory
Unemployment	51	Social Security Law	Ministry of Labor	District	Contributory
Social Assistance (number of households)	145 <u>2/</u>	Social Assistance Law	Local authorities/ Ministry of Labor	Municipality/ Commune	Non-contributory
Price subsidy/ compensation	1066 <u>3/</u>	Decrees of the Council of Ministers	Employer/ Institution administering base benefit	District; Municipality/ Commune; employer	Non-contributory

1/ Includes number of pensioners, and individuals on maternity leave.

2/ This is equivalent to approximately 572 thousand people, or 18 percent of the population.

3/ Estimated for energy compensation which is universal and supposed to be granted per dwelling.

Table 3. Albania: Social Security Contribution Rates Across Europe
(In percent)

Country	Payroll Contribution Rate	Employers	Employees
Romania	27.5	23.5	4.0
Average for OECD	32.0	0.0	0.0
Turkey	33.5	19.5	14.0
Russia	38.0	36.0	2.0
Albania	42.5	32.5	10.0
Poland	45.0	45.0	--
Hungary	53.0	43.0	10.0

Table 4. Albania: Compliance with Social Security Contributions in 1994

	Employment (‘000)	o.w. ineligible for SS contrib. 1/	Eligible to contribute (‘000)	Contributors reported by SSI	Average wage (leks)	Social security contributions 2/ (million leks)	Actually collected	Rate of compliance
Public sector								
State enterprise	156	8.5	147.5	131	4477	2813	2585	91.9
Budgetary institutions	174	9.5	164.4	149	4220	2956	2791	94.4
Total public sector	330	18.0	311.9	280		5769	5376	93.2
Private sector								
Agriculture 3/	155	...	155	42		201	79	39.5
Urban private firms 4/	96	...	96	86	2971	1195	928	77.7
Total private sector	347		347	214		1396	1008	72.2
Total contributions						7165	6384	89.1

Sources: INSTAT, the Social Security Institute and staff estimates.

1/ The group ineligible to contribute to the SSI includes women on maternity leave, and those on sick leave.

2/ The contribution rate levied on the wage bill was 35.5 percent. The remaining 7 percent was to be contributed from the budget.

3/ Employment in agriculture is the number used by the SSI for 1994 and 1995 revenue projections.

4/ Staff estimates suggest that the number of employed in the private sector could be as high as 241,000.

Table 5. Albania: Pension Benefits in Albania

Type of pension	Number of Recipients as of 1/1/95 (in thousands)	Eligibility criteria	Contributory/non-contributory <u>1/</u>
Old-age:			
urban	447	Retirement age 60 years old for men, 55 for women; 35 years of social contributions; retirement test for pensioners <u>2/</u>	Contributory
full			
partial	317	Retirement age 60 years old;	
rural	130	20-34 years of insurance same as for full pension	Only partially contributory until 1/1/97
Disability:			
urban	26.6	Complete disability; disability to any economic activity; minimum insurance period depends on the age of insured;	Non-contributory
full			
partial	21.8	Minimum insurance period of 20-34 years	Partially contributory
rural	4.8		
Survivor's:			
urban	67.5	50 years old for women and 60 for men or dependent child under 8 years old	Contributory
rural	46.3		
	21.2		Contributory
Merit: <u>1/</u>			
urban	1.7	Participation in National Movements; remarkable results in science, arts, culture, politics and economics; victims of political persecution	Non-contributory
	1.7		

1/ According to the Law.

2/ Introduction of retirement test means that a pension is paid only if the individual retires from economic activity.

Table 6. Albania: Average Pension Benefits in 1993–95

	Ave. Annual Increase (In percent)		Inflation
	Urban	Rural	
1993 <u>1/</u>	157.7	100.0	85.0
1994	147.3	142.1	22.6
1995	118.3	109.4	7.9

Source: Social Security Institute and IMF staff estimates.

1/ December 1992 is the base.

Table 7. Albania: Number and Composition of Pensioners

	1993	1994	1995 est.
	(In thousands of people)		
Total ('000),	470	473	514
o.w. Urban	313	317	342
Rural	157	156	172
	<u>As a percent of total</u>		
urban	66.6	67.0	66.5
rural	33.4	33.0	33.5

Composition of pensioners by categories:

	<u>As a percent of total</u>		
Total	100	100	...
o.w. Old-age	73.3	75.8	...
Disability	8.9	5.6 <u>1/</u>	...
Survivors'	13.7	14.3	...
Merit	0.3	0.4	...
Early retired <u>2/</u>	3.9	4.0	...
	<u>As a percent of total</u>		
Total old-age group,	100	100	...
o.w. Regular	40	40	...
Occupational <u>3/</u>	60	60	...

Source: Social Security Institute and IMF staff estimates.

1/ Reduction in the number of disability pensioners due to decrease in the number of invalids since childhood.

2/ Does not include the number of early retirees entitled to occupational pensions.

3/ Occupational pension benefits are granted to workers in difficult occupations.

Table 8. Albania: Disparities in Number of Children Per Woman

	Women with children	Number of children:				per woman (number)
		0-2	3-5	6-8	over 8	
<u>(As a percent of total)</u>						
Women with children,	<u>100</u>	<u>42.4</u>	<u>33.8</u>	<u>17.0</u>	<u>6.8</u>	3.6
o.w. Urban	39.5	50.8	38.1	22.5	18.3	2.9
Rural	60.5	49.2	61.9	77.5	81.7	4.1
<u>(As a percent of group total)</u>						
By mother's education:						
Illiterate	<u>100</u>	<u>15.7</u>	<u>25.2</u>	<u>37.5</u>	<u>21.5</u>	6.0
Urban	23.6	26.7	27.4	21.9	19.7	5.6
Rural	76.4	73.3	72.6	78.1	80.3	6.1
Primary education	<u>100</u>	<u>35.5</u>	<u>41.1</u>	<u>18.0</u>	<u>5.3</u>	3.7
Urban	<u>29.0</u>	30.7	32.3	22.0	16.2	3.4
Rural	<u>71.0</u>	69.3	67.7	78.0	83.8	3.9
Secondary education	<u>100</u>	<u>71.9</u>	<u>26.4</u>	<u>1.5</u>	<u>0.2</u>	1.9
Urban	67.7	70.3	62.3	43.6	36.4	1.9
Rural	32.3	29.7	37.7	56.4	63.6	2.1
Higher education	<u>100</u>	<u>83.4</u>	<u>16.3</u>	<u>0.3</u>	<u>0.1</u>	1.7
Urban	88.3	89.2	84.1	56.4	62.5	1.7
Rural	11.7	10.8	15.9	43.6	37.5	1.7

Source: "Population and Housing Census in 1989 -- Principal Results." Central Directory of Statistics. Tirana. 1991. p.55, and staff estimates.

Table 9. Albania: Evolution of Unemployment

	1992	1993				1994				1995		
	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3
Unemployment rate ^{1/}	27.8	31.1	32.2	29.2	23.4	20.2	19.4	19.4	19.4	19.3	18.8	16.7
As a percent of registered unemployed:												
Women	51.0	50.9	50.3	48.5	47.5	47.1	47.2	47.2	46.3	45.8	45.7	43.9
Rural workers	14.5	...	...	...	...	19.9	18.8	18.3	18.5	19.6	15.3	12.3
Those receiving benefits as a percent of total	77.1	78.4	77.4	51.2	35.7	32.8	27.4	23.1	19.7	20.4	19.7	22.0
As a percent of those receiving benefits:												
Women	...	...	...	...	...	41.7	41.7	40.6	37.2	36.1	37.9	38.4
Rural workers	...	...	...	...	...	21.2	21.5	22.1	24.3	22.5	20.5	18.3

Sources: The Ministry of Labor, and staff estimates.

^{1/} Estimated as a percent of the domestic labor force.

Table 10. Albania -- Unemployment in Selected Regions

	<u>Unemployment rate 1/</u>				
	<u>(Percent of labor force)</u>				
	<u>09/94</u>	<u>12/94</u>	<u>03/95</u>	<u>06/95</u>	<u>09/95</u>
Berat	15.8	15.9	16.6	14.7	12.0
Diber 3/	14.0	13.4	8.8	7.3	6.1
Durres	10.0	10.2	9.8	8.2	6.3
Elbasan	23.4	23.7	23.1	21.9	16.6
Fier	11.2	11.2	11.8	11.6	7.5
Gramsh	24.2	25.1	26.0	26.4	23.1
Gjirokaster	7.2	7.3	7.3	7.3	5.9
Kolonje	16.5	16.1	15.3	14.6	9.7
Korce	7.9	8.0	8.5	7.9	7.1
Kruje	9.9	10.0	9.4	8.6	6.5
Kukes 3/	19.1	19.9	20.0	19.9	12.9
Lezhe	13.7	12.5	12.8	11.7	9.7
Librazhd 3/	22.7	23.0	21.7	22.4	4.4
Lushnje	13.5	12.4	11.4	9.7	7.8
Mat 3/	25.5	25.9	26.5	23.9	15.1
Mirdite 3/	11.7	12.1	12.5	13.3	12.2
Permet	11.6	10.3	10.2	10.1	7.5
Pogradec 3/	16.6	16.7	17.5	18.1	12.4
Puke 3/	7.1	7.4	6.7	5.6	6.0
Sarande	10.1	9.5	8.2	7.5	3.6
Skrapar	18.7	19.2	19.4	19.1	16.0
Shkoder 3/	18.7	18.0	16.9	17.0	10.2
Tepelene	5.9	6.1	8.4	10.9	10.8
Tirana	17.3	17.3	20.1	17.7	8.6
Tropoje 3/	39.6	42.1	46.4	47.4	26.0
Vlore	10.6	10.3	9.4	8.8	9.3

Memo item:

National rate 2/

Source: 1989 census, INSTAT data, and staff estimates.

1/ Unemployment rates calculated are somewhat misleading since they do not take into account the number of emigrants.

2/ Estimated as a percent of domestic labor force (without emigrants).

3/ The Northeast and Mountain region have the least favorable conditions for economic development.

Table 11. Albania: Differentiation in Social Assistance Benefits by Family Size

	July	August	1994 September	October	November	December	January	February	1995 March	April	May	June
Family size	(In percent of basic benefit) 1/											
Full social assistance benefit												
Municipality:												
up to 2 members	100	100	100	100	100	100	100	100	100	100	100	100
3-4 members	163.0	112.4	151.5	151.5	152.4	152.4	123.7	142.6	143.7	143.1	153.3	144.5
5-6 members	176.2	178.1	173.6	173.6	188.3	188.3	144.5	161.4	165.1	171.6	173.0	164.5
more than 6 members	215.0	221.8	209.5	209.5	221.3	221.3	172.0	190.4	169.5	191.1	192.9	186.1
Commune:												
up to 2 members	100	100	100	100	100	100	100	100	100	100	100	100
3-4 members	176.2	184.7	147.9	147.9	133.7	133.7	163.2	157.7	153.8	149.3	144.6	148.4
5-6 members	203.6	139.4	189.1	189.1	179.7	179.7	183.4	190.0	171.2	170.0	160.8	163.5
more than 6 members	281.3	185.7	206.3	206.3	197.6	197.6	224.5	228.2	207.6	189.5	193.4	165.6
Partial social assistance benefit												
Municipality:												
up to 2 members	100	100	100	100	100	100	100	100	100	100	100	100
3-4 members	103.9	98.4	111.2	111.2	119.7	119.7	127.9	122.7	116.2	101.4	131.3	134.8
5-6 members	130.5	119.8	136.1	136.1	131.6	131.6	151.6	139.5	137.1	109.7	158.4	150.0
more than 6 members	182.7	189.8	178.6	178.6	145.8	145.8	215.3	175.3	149.0	121.5	171.0	157.0
Commune:												
up to 2 members	100	100	100	100	100	100	100	100	100	100	100	100
3-4 members	123.4	121.0	117.7	117.7	118.2	118.2	110.1	115.2	118.2	113.6	119.3	119.0
5-6 members	148.6	140.0	135.0	135.0	128.6	128.6	124.1	134.5	134.0	135.6	140.4	141.3
more than 6 members	183.9	175.5	161.3	161.3	146.6	146.6	140.1	152.4	155.3	164.6	168.2	152.7

Source: The Ministry of Labor and staff estimates.

1/ The full social assistance benefit for a two-person household was set at a level equivalent to 140 percent of a single person's unemployment benefit.

Table 12. Albania: Composition of Social Assistance Benefit Recipients

	1992		1993		1994		1995
	H1	H2	H1	H2	H1	H2	H1
	<u>(As a percent of total population)</u>						
Full social assistance	7.8	7.9	8.7	13.1	5.7	6.6	6.7
Urban	2.6	2.6	3.4	4.0	4.6	5.7	6.0
Rural	5.2	5.2	5.3	9.1	1.1	0.9	0.7
Partial social assistance	...	...	...	...	11.7	10.7	10.8
Urban	...	...	...	...	1.4	1.0	0.7
Rural	...	...	...	...	10.3	9.7	10.0
Total	7.8	7.9	8.7	13.1	17.5	17.2	17.4

Source: The Ministry of Labor, Institute of Statistics and staff estimates.

Table 13. Albania: Cost of Social Assistance Benefits

(As a percent of total)

	1994			1995	
	Q2	Q3	Q4	Q1	Q2
Full social assistance	50.7	57.9	63.5	57.0	61.1
Urban	38.6	47.7	55.0	50.2	54.4
Rural	12.0	10.1	8.6	6.8	6.6
Partial social assistance	49.3	42.1	36.5	43.0	38.9
Urban	7.0	3.6	3.2	2.9	3.8
Rural	42.3	38.5	33.3	40.1	35.1
Total	100	100	100	100	100

Source: The Ministry of Labor and staff estimates.

Table 14. Albania: The History of Price Compensation

Date of introduction	Type of compensation	Individual compensation (leks)	Dependent compensation (leks)	Number of recipients as a percent of total population	Number of dependents per recipient
August 1992	Food price	280	200	64	0.7 <u>1/</u>
August 1993	Bread price	214	214	85	0.7
April 1994	Energy price	350	--	33	--
November 1994	Energy (temp.)	150	--	19	--

1/ The number of dependents per recipient of compensation was different for different groups of recipients and changed over time. The table shows the number of dependents per the state-enterprise worker and budgetary employee at the time when compensation was introduced.

Table 15. Albania: Eligibility for Energy Compensation
(Decree No. 138, March 1994)

Eligibility for the Energy Compensation	Level (leks/month)
Employees of budgetary institutions, joint-venture companies, banks, INSIG, the Ministry of Tourism enterprises, political and social associations; Unemployment benefit recipients; Urban pensioners; Disability pensioners; Partial social assistance recipients (urban)	350
Employees of state-owned enterprises	300
Rural pensioners -- ex-state-farm workers	200
Partial social assistance recipients (rural)	150
Full social assistance recipients	600
Families with one person working (otherwise entitled to 350 lek/month)	700 (maximum)

CHART 1

Albania: Revenues of the Social Security Institute
(As % of GDP)

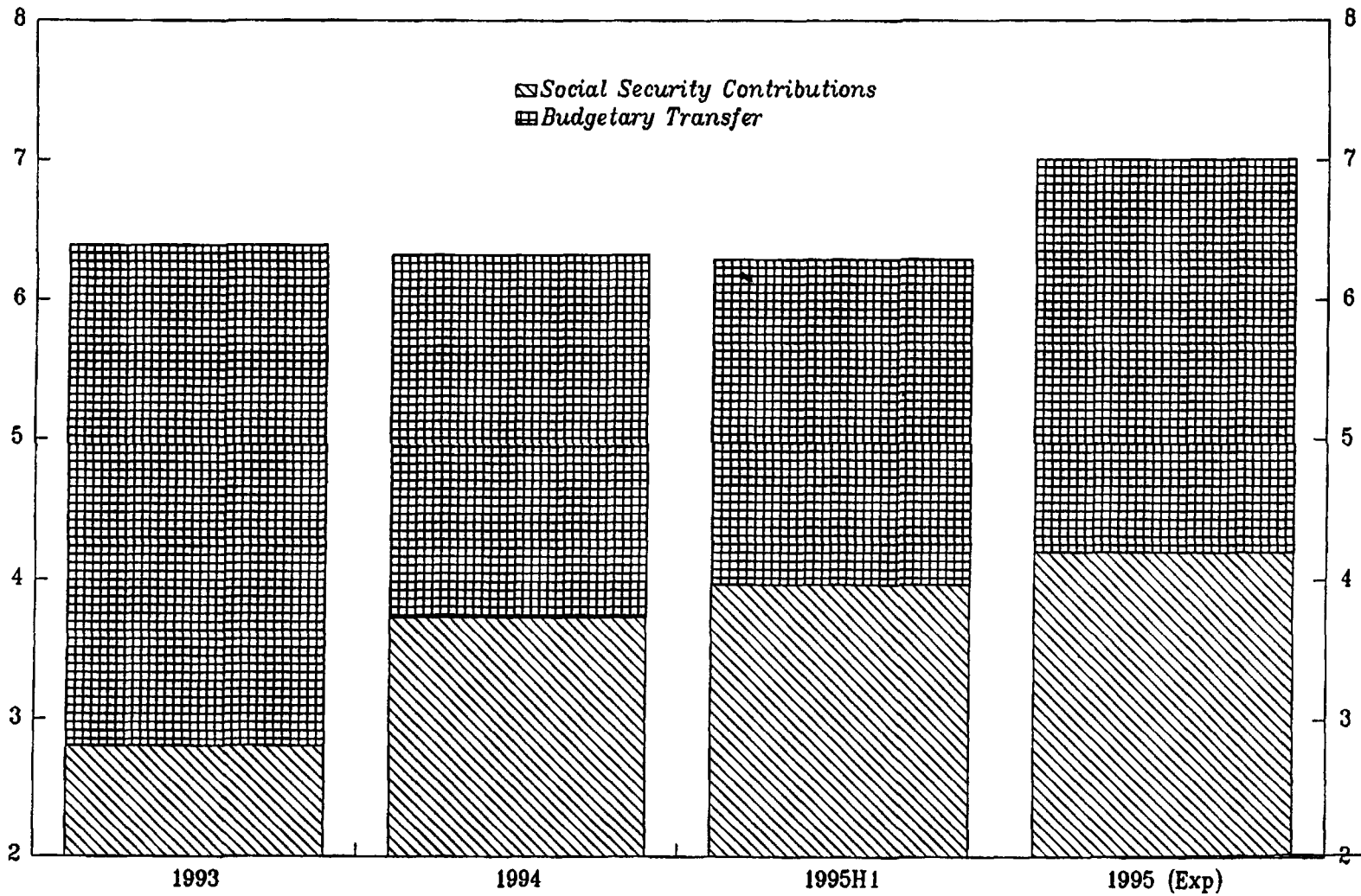


Chart 2

Albania: Distribution of Pension Benefits, 1994

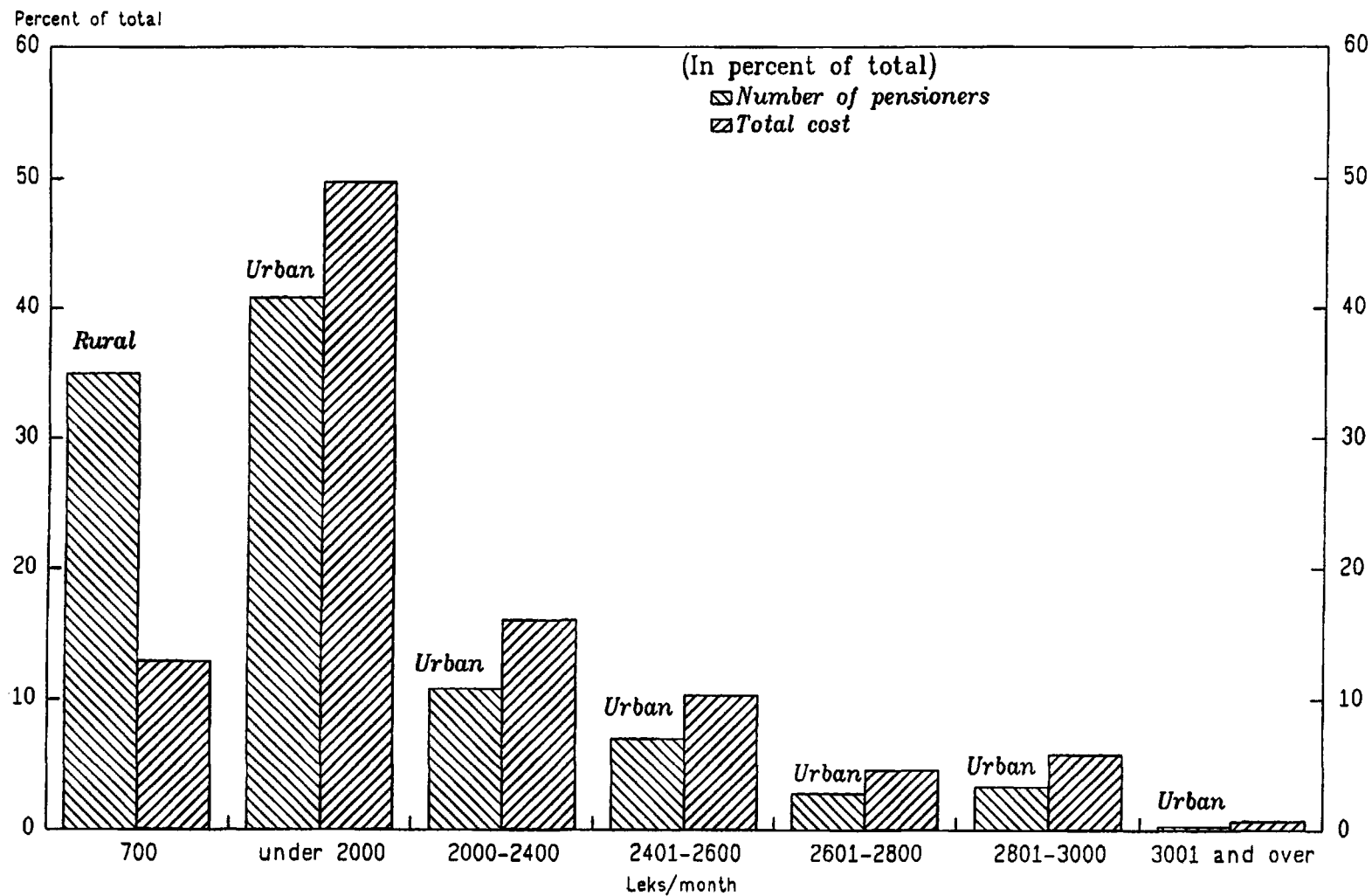
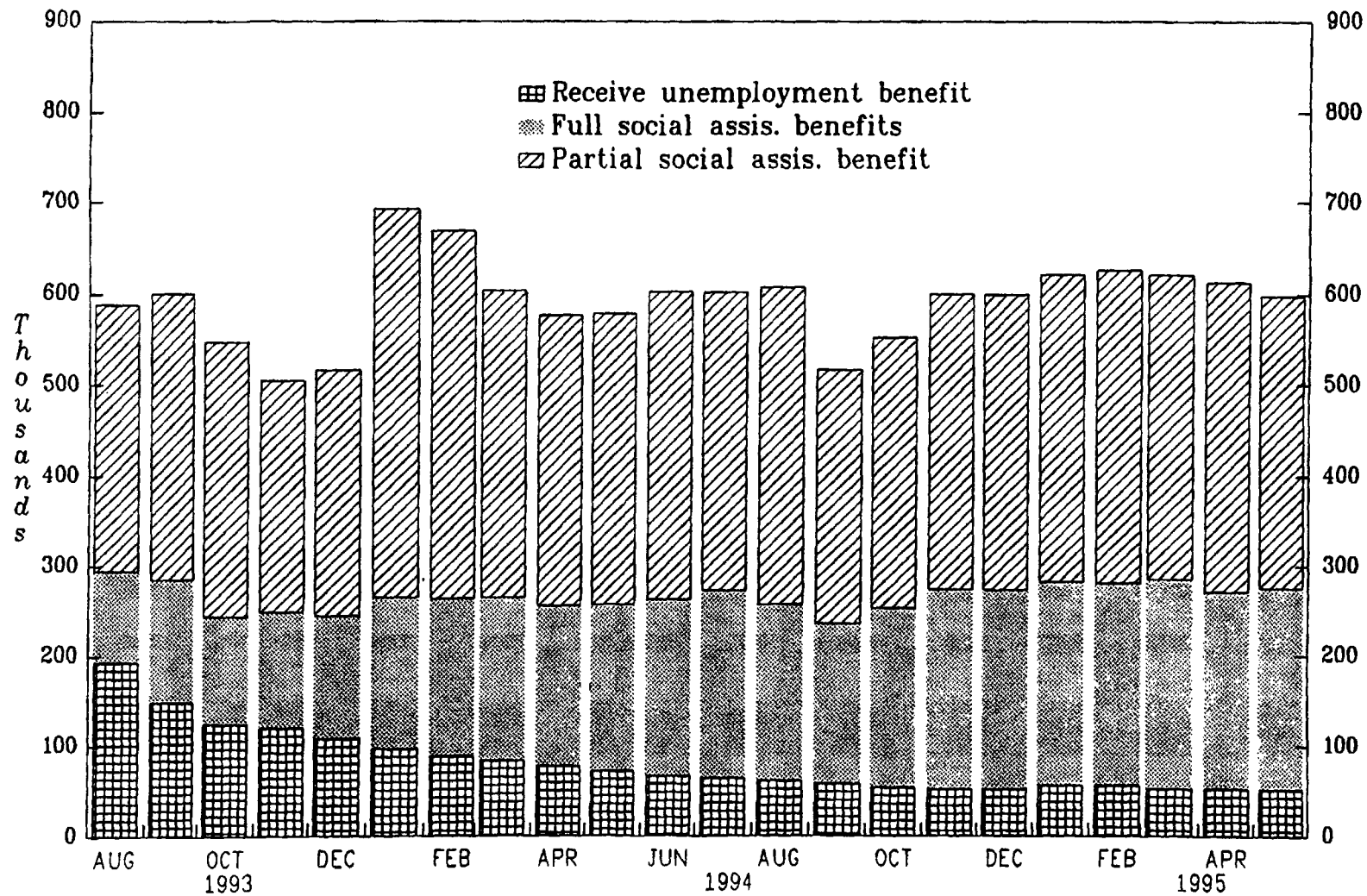


CHART 3

Albania: Changes in the number of Recipients of
Unemployment and Social Assistance Benefits.



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