REFORMING THE PENSION SCHEME OF SELF - EMPLOYED IN AGRICULTURE

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Abstract

This paper has analysed the pension scheme of self-employed in agricultural sector taking into consideration the forthcoming reform. Key problems facing rural pension scheme in Albania were identified with an overview of the scheme. With the disintegration of agricultural cooperatives and enterprises accompanied by land distribution to rural inhabitants constituting 65% of the population, considered as self-employed in agriculture by law. Therefore, the number of contributors to the social insurance drastically dropped raising the dependency coefficient ratio. After ten years, in 2002 this coefficient improved due to the increase of contributors. However, the replacement coefficient is still low. Later this ratio has increased much more than the same ratio for urban people. Further analysis shows that the so-called obligatory social insurance contribution has been very low, about one USD per month to gain 1 year of contribution. The analyses shows that if such a scheme was relatively stable in the beginning, with the increasing number of pensioners from rural areas, the social insurance fund could not cope and therefore it has to be afforded by the state contribution, raising the fiscal burden and deforming the scheme. The paper draws some conclusions and makes recommendations for changing the pension policy.

Keywords: *self – employment in agriculture, pension scheme, replacement coefficient*

Introduction

In 2012 Albania spent 5.2 percent of GDP on pensions, much less than the EU countries or the average for Eastern Europe. Relative to the average wage, minimum pensions are higher in Albania than in most other countries, which makes it difficult to differentiate benefits by earning or contribution level without sending costs even higher. Spending on pension programs increased very little over 2005–12, from 4.9 percent of GDP in 2005 to 5.2 percent in 2012.

In rural areas, disincentives to contribute are even more obstinate because those earning minimum pensions receive additional allowances that raise their total incomes higher than those of pensioners who previously earned more. Disintegration of agricultural cooperatives and enterprises in 1990 was accompanied by land distribution to rural inhabitants constituting 65% of the population. Although very weak at the beginning, these households gradually produced surplus to sell in the market. It was therefore considered fair to include them in the social protection scheme. They were considered as "self-employed in agriculture" by law in 1993. This category, as the others, is protected by the obligatory insurance. Besides employees of the agricultural state cooperatives and enterprises, it also includes other workers in the state service which got agricultural land according to law 7051 dated 19.07.1991 "On land distribution". Initially the burden of insurance was with the head of the family, despite the organization of the private activity, but later was an individual obligation.

They would have paid only part of the contributions paid by other self-employed individuals, while the difference was paid by the state budget. This political choice was conditioned by the fact that although the population of the village has received the plots of land they were unable to make a profit. Agriculture constituted the main economic activity for the country and needed support. In that period, only 35% of the population was living in urban areas. While the pensioners in urban areas occupied about 10% of the population, the specific weight of pensioners in rural areas constituted only 3% of the population. Moreover, there were differences in the insurance scheme in relation to the level of profit that was higher for the state employees compared to ex-cooperative employees. These arguments were forming the rationale for policies taken by the government to alleviate rural inhabitants from state obligations to pay taxes and contributions.

This research aimed at analyzing the current pension scheme and using the income equalization technique to adjust the pension accordingly. This should lead to some recommendation on the policy changes.

Material and Methods

The analysis used in this document assessed the adequacy of retirement incomes for rural pensioners by comparing the rates for simulated individuals. This allows the assessment of policy changes that will have impacts several decades in the future. Primary data related to the total amount of contributions, number of contributors, etc. were collected from the Social Insurance Institute and were used to calculate various indicators, like dependency coefficient ratio (the ratio of beneficiaries to contributors in the social insurance scheme). Secondary data were obtained from official publications (World Bank Albania 2006a, b, 2013; Ministry of Finance 2013a, b, c; ILO 2007, 2009; OECD 2011, ISSH 2014), official gazette, national dailies and internet sources. The technique used is the income equalization (Courchene, 1998), which recognizes these economies of scale, and adjusts the pension accordingly. Assumptions about inflation, earnings growth and the labour market are consistent with medium and long-term assumptions.

Results and Discussions

Calculation of the dependency coefficient ratio shows an increase for the period 1994 – 1999 for rural areas. After ten years, in 2002, this coefficient was improved due to the increase of contributors (the ratio of the average pension to the average salary) but remains low. Later this ratio has increased much more than the same ratio for urban people. Such increase was due to the higher rate of increase of the average pension for the villages relative to the minimum contributory salary. In 2009, "self–employed" in rural areas paid an annual contribution of about 100 EUR for plain areas and 63 EUR for mountainous areas, thus about 26% of the contribution and the remaining 74% was paid by the state. While for 2011, the monthly contribution of "self–employed in agriculture" in plain areas has been 13 EUR and in mountainous areas 8.4 EUR, the contribution of self–employed in urban areas has been 37.6 EUR. Thus, the contribution of "self–employed in agriculture" for 2011 has been 1/3 of the monthly contribution of self–employed in urban areas.

More than 500 000 people "self–employed" in agriculture entered into an "obligatory" payment contribution scheme which *de facto* where not obligatory. The average monthly contribution fee was less than 1 EUR. A villager, at a working age, to ensure one year of seniority for pension purposes, should have paid a little more than 1 EUR per year. This logic continued although the contribution fee increased. The latest has progressed in the opposite direction with the requirements for the pension fund. If in the first instance, the payment effect of such a low contribution fee was not so sensible towards the misbalance contribution – pension fund, gradually, the number of pensioners form the "self – employed in agriculture" category was increasing, i.e. those paying 1 EUR a month to get the pension.

Under such conditions, an individual has paid very little and they were getting a pension at least fifty times more than the amount of contribution. Thus, the self-employed in rural areas were paying much less contributions compared to the minimum contributions of self-employed in urban areas. The difference was covered by the state budget as a contribution and not as a state subsidy. However, referring to the data, it should be stressed that the contributors in rural areas contribute by about 15% of the necessary contribution and they get full rights in the pension system. In other words, 85% of the contributors in the rural sector "does not pay" the contributions. If we will expel this 85% of rural contributors, the poverty ratio of the system would increase to 1.36 meaning that each contributor should support 1.36 pensioners.

Table 1. Amounts of contributions (in EUR) by self – employed individuals living in urban or rural areas and the share (%) of subsidy paid by the state budged

Insurances	RURAL		URBAN		SUBSIDY		
	yearly	month	yearly	monthly	yearly	monthly	share
Plains							
Social insurance	214.3	17.9	375.1	31.3	160.8	13.4	43%
Health insurance	24.5	2.0	110.9	9.3	86.4	7.2	78%
Total insurance	*238.8*	*19.9*	*485.0*	*40.6*	*247.2*	*20.6*	*51%*
Mountains							
Social insurance	164.3	13.7	375.1	31.3	210.8	17.6	56%
Health insurance	24.5	2.0	110.9	9.3	86.4	7.2	78%
Total insurance	*188.8*	*15.7*	*485.0*	*40.6*	*296.2*	*24.8*	*61%*

Results of such policy were a deepening of the fiscal burden of pensioners on state budget but also a deformation of the entire scheme. Therefore, although a ceiling was applied for pensions, it is still unclear what is the minimum benefit of a pensioner that fulfills the specific requirements of seniority and wage. The lack of a minimum pension limit is a typical feature of pension categories in villages. Under such conditions, indicators related to the minimum living conditions at poverty level of an unemployed, were unfairly hided by the pension scheme.

As the village pensions constitute a central part of the pension scheme in Albania, they will be gradually replaced with the so – called state pensions. Even according to the new reform approved, a new methodology was applied for calculating a pension for self – employed in agriculture. This method is similar to the pension of the urban area and is made up of two parts: a basic pension (village), defined by the Council of Ministers and a supplement of 1 per cent of the minimum salary for every year of contribution to the social insurance scheme. Based on the our methodology, a person who has been working in the ex – agricultural cooperatives and has regularly contributed to the social insurance scheme since 1994 and onwards as a self – employed in agriculture, in 2004 would have benefited a basic village pension of 18.5 EUR/month and a supplement of 7.4 EUR/month, totaling about 26 EUR/month. This pension would have represented about 54 per cent of the minimum city pension. In 2006 this supplement would have reached 10 EUR/month for 12 years of insurance added to the basic pension of 29.4 EUR/month, totaling a village pension of 39.4 EUR/month and representing 49.8% of the minimum city pension. In 2009 this pension has reached the value of 45.3 EUR/month equal to 61,7% of the minimum city pension (73.4 EUR/month).
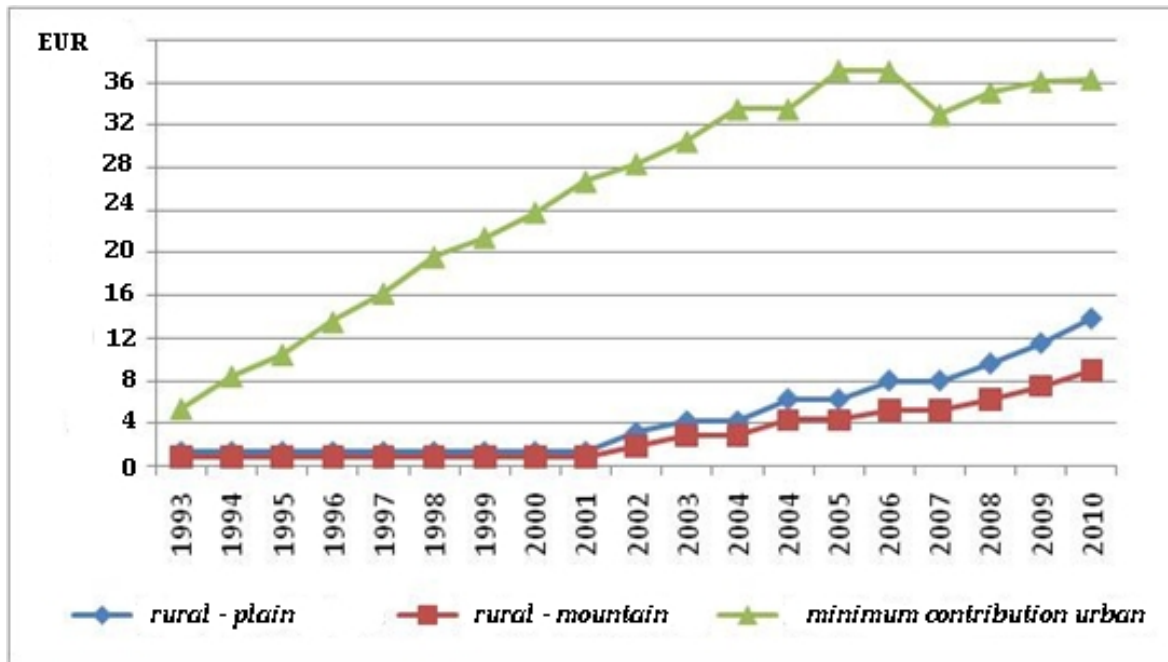
Figure 1. Comparison of the amounts of contributions between urban and rural areas and between mountainous and plain areas
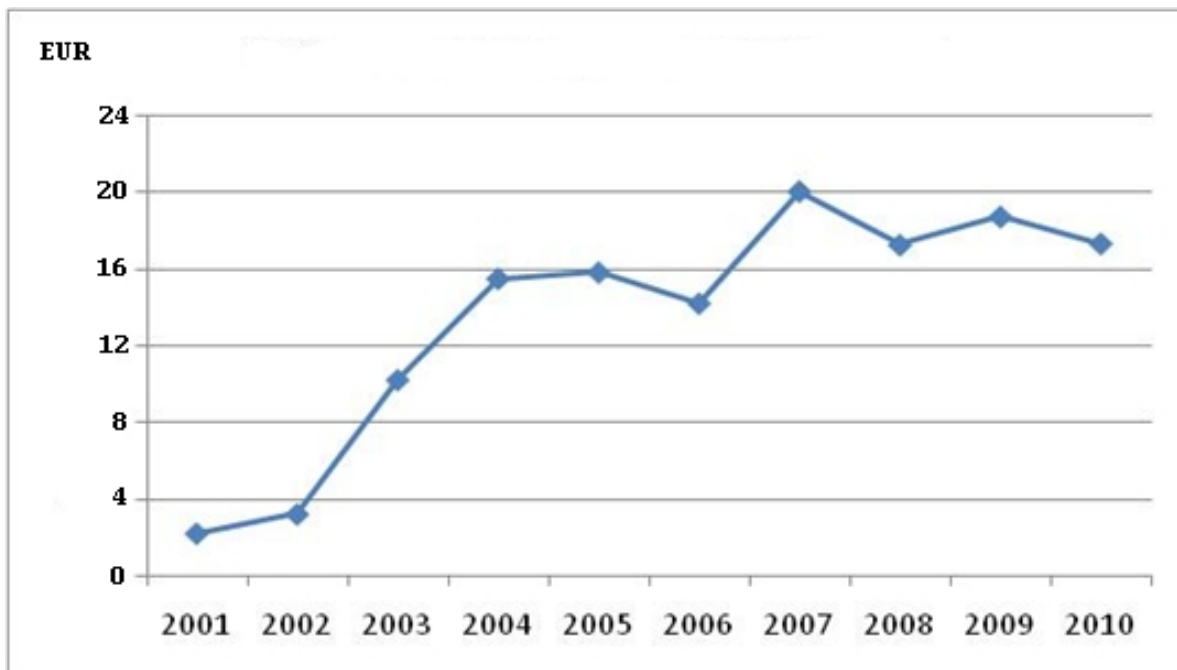

Figure 2. Incomes of self-employed individuals

In 2010, the monthly village (rural) pension reached about 50 EUR/month equal to 65,3% of the minimum city pension and in 2011 the monthly rural pension was 53.4 EUR/month equal to 67% of the minimum urban pension (79.4 EUR/month). In 2012, the minimum pension in the village was 56 EUR/month equal to 67.8% of the minimum city pension (82.6 EUR/month). Using this logic of calculations for the yearly indexation of the basic village pension, based on a minimum wage which increases every year, it is assumed the rural and urban pensions will be equaled by 2014.
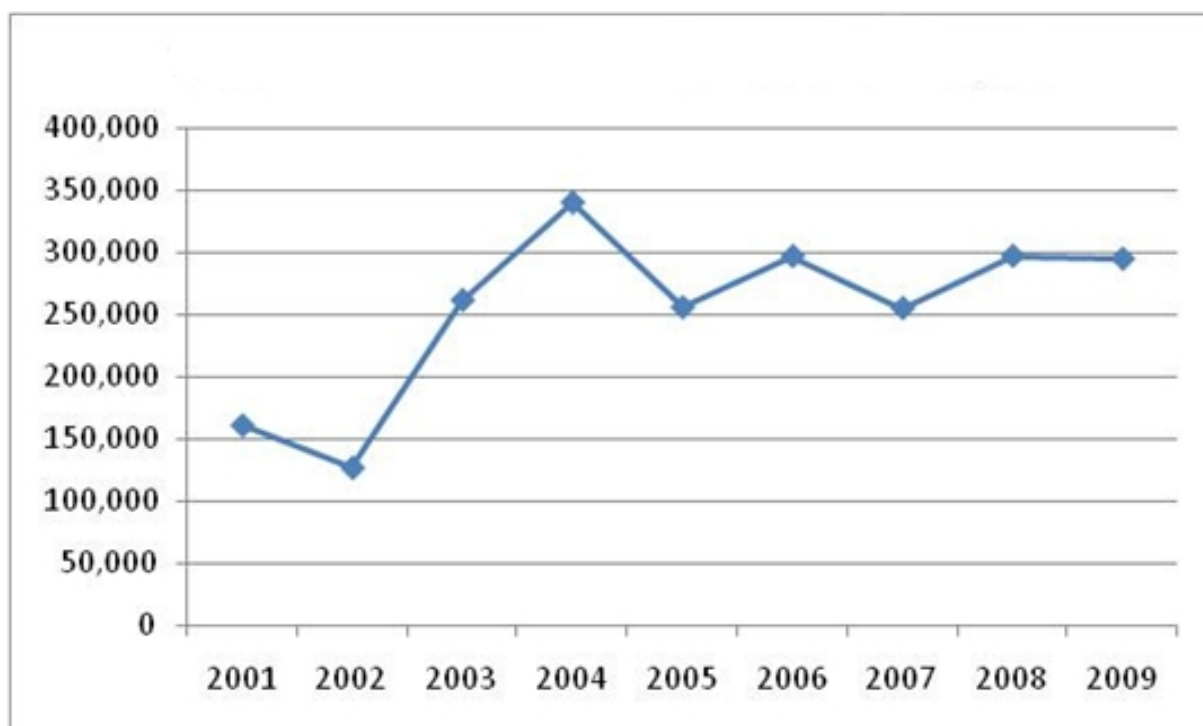
Figure 3. Dynamic of self – employed in agriculture

For 2013, the number of self – employed in agriculture for plain areas has been 47.824 persons whilst for mountainous areas 16.450 persons, totalling 64.274 persons. Compared to 2012, there is a reduction in the number of self – employed. In 2012, a total of 66.620 people were self – employed and 7.748 were at the age of 16 – 30 years old.

It is calculated that the financial effects for the budged by 2020 would be 10 milion EUR compared to 2.7 million EUR in 2000.

Conclusions

The government was endeavoring to provide better benefits to pensioners and improve their income security, but the changes were made without a comprehensive approach to all the challenges in the system. As a result, a pension system that is overly redistributive and fiscally unsustainable. In urban areas, there is significant redistribution from high- and middle-income earners to low-income earners. As a result, average and minimum pensions are now virtually equivalent. The benefit structure appears to be flat, although to be eligible for a pension when they retire, people must have paid in amounts indexed to their incomes, which naturally differ. As a result, the urban scheme has significant disincentives to contribute for longer periods and to declare full earnings. The scheme for rural residents requires transfers from the budget both to supplement contributions and to finance the pension system deficit. Consequently, rural pensions have become a de facto social assistance scheme, although one administered as if it were contributory. Lower contribution rates and sizable increases in pensions have affected system fiscal sustainability. Although the government has to finance an increasing pension system deficit, the extensive informality in the labor market means that a significant share of the elderly will not have access to a pension benefit in future.

There is political pressure to raise the current rural pension, which is *de facto* social assistance, to the level of the urban minimum pension despite minimal rural contributions; instead it should be replaced with a social pension for non-contributors that would also cover those in urban areas who do not work or contribute. The advantage for workers is that their contributions directly support worker benefits and are no longer channeled to the social

assistance component. From the government's perspective, the political pressure to equalize rural with urban pensions should disappear and the government should be able to provide benefits more affordably.

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