

The Kosovo Pension Reform
David Snelbecker
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USAID became involved in pension reform in Kosovo in Spring 2007. The old pension system had not paid benefits since the conflict, and everyone agreed that some pension system was needed, though there was not clear consensus on the characteristics of that system.

The old system before the conflict had numerous problems. The old system was a typical East European system with very high contribution rates, frequent delays in payment of pensions, a high level of evasion by contributors, early retirement ages, special categories of earlier retirement, a complicated benefit formula, and increasing financial unsustainability. Only part of the elderly population was covered. In particular, many Kosovars forced out of formal-sector work during the Milosevic years did not have opportunity to continue earning credits. In short, the old system was ineffective on several fronts. Although the Kosovar population is young, it will start to age rapidly and therefore will be subject to the same demographic pressures that plague many unreformed European systems. Given these problems in the old system, and in the historical context of major pension reforms being adopted throughout Europe and worldwide, it was decided to adopt a completely new, modern pension system following international best practices.

The new mandatory pension system consists of two components. The first component in the system provides an old-age “basic pension” (paid to all Kosovars, 65 years of age and older) and a disability pension, both of which are funded from general revenues rather than an earmarked wage tax. Pensions are paid through the banking system rather than through the postal service, reducing administrative costs. The disability pension is narrowly focused on total and permanent disability, ensuring that scarce resources are well focused on the truly disabled.

The second component of the system is a mandatory, defined-contribution, savings pension program. The program requires all working, habitual residents of Kosovo to contribute 5% of gross salary, matched by a 5% employer contribution. Contributions and records are managed by the Kosovo Pension Savings Trust (KPST), an independent body with strong governance and supervision, established solely for the purpose of administering the savings component of the pension system. The KPST invests participants’ assets on their behalf. Very high standards are set to ensure security of pension investments at the same level of safety enjoyed by other European citizens for their pension investments. Several Governing Board members are “representative” of Kosovo society, while the majority of Board members must have strong “professional” experience, meeting criteria that would be required for a trustee by any major European pension fund that follows good investment practices. (These high standards also necessitate investment abroad at present, at least until Kosovo’s domestic financial markets are much more developed.) Strong governance processes and top-quality

Governing Board members who meet high international professional standards are critical for ensuring safe long-term guardianship of participants' pension assets. The process of collecting contributions is centralized to minimize administrative fees.

The reform has achieved a number of important policy outcomes. The Basic Pension helps avoid high payroll taxes since there is no wage-based "social contribution"—it is funded from the general budget. The modest contribution to funded pension accounts, coupled with an absence of other payroll taxes and low personal income taxes, should avoid labor-market distortions that have affected many other countries. In this way, the system is conducive to job creation and economic growth. The Basic Pension achieves near universal coverage of all elderly over 65 in an environment where only a small share of the population earns formal wage income, in contrast to the old Yugoslav system that reached only approximately half of Kosovo's elderly. The Basic Benefit is tied to the cost of a basic monthly food basket, linked to official government statistical surveys, in order to contain long-term costs with a real anchor. This long-term fiscal sustainability leaves enough fiscal room for other important needs-based social programs rather than crowding out such programs. The system adheres to a principle of clear division of roles, where the first component ensures poverty avoidance and the second component serves as the main vehicle for savings. Funds under the second component are securely invested according to international best practices, and already are returning positive real net returns to participants, with comparatively low administrative fees. The foundation for supervision of mandatory and voluntary funded pensions is strong, with effective transparency requirements.

The pension system of Kosovo is one of the most successful social and economic programs in Kosovo, with strong institutions that provide efficient, safe services to the population. The new pension system meets high European standards and will provide robust pensions for current and future generations of pensioners.

As Kosovo approaches likely independence near end of 2007, the political environment will change dramatically. To what extent the principles and institutions of the Kosovo pension reform will be preserved into Kosovo's next stage of development remains to be seen.