



EUROPEAN SOCIAL POLICY NETWORK (ESPN)

Financing social protection

Albania

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Social Europe

EUROPEAN COMMISSION

Directorate-General for Employment, Social Affairs and Inclusion

Directorate C — Social Affairs

Unit C.2 — Modernisation of social protection systems

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European Commission

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European Social Policy Network (ESPN)

**ESPN Thematic Report on
Financing social protection**

Albania

2019

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Quoting this report: Ymeri, Sabina (2019). ESPN Thematic Report on Financing social protection – Albania, European Social Policy Network (ESPN), Brussels: European Commission.

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Summary

Albania's overall social protection spending is significantly lower than the EU average although it more than doubled between 2005 and 2016. In 2016, Albania spent 9.4% of its GDP on social protection, much lower than the European average of 28%. Expenditure in the sector is dominated by social insurance outlays and non-contributory cash programmes targeting poverty and disability. The social protection system in Albania provides coverage to almost half of the population. Spending levels, however, remain low due to the very modest size of pensions and poverty cash benefits.

Government revenue finances more than half of social protection spending. The fiscal revenue structure relies heavily on indirect consumption taxes. In 2014, a progressive personal income tax system was adopted, with rates of 0%, 13% and 23% levied at different income levels. Revenue from personal income taxes accounted for only 7.7% of total budget revenue in 2016. While it may be argued that the progressive tax system contributes to reducing inequalities and has the desired redistributive impact, it may also create disincentives for the formalisation of employment or the declaration of full earnings. This may not only undermine the fiscal sustainability of the pension scheme and increase pressure on the general government budget, but it may also lead to increased precariousness and vulnerability in the labour market.

Spending on pensions is relatively low, at an average of 6.8% of GDP between 2005 and 2017, despite having increased in both nominal and relative terms. The pension system underwent a thorough reform in 2014, aimed at better linking contributions and benefits by expanding the pension benefits, and hence creating a greater incentive to participate in the scheme. The prevalent redistributive character of the scheme was revised, and a social pension was introduced for the first time in 2015. Fiscal sustainability of the pension scheme has gradually improved, complemented by an increase both in the number of contributors and in the pension amount.

The major non-contributory social protection programmes with extensive coverage include the means-tested poverty-alleviation programme (social assistance) and disability benefits. The relative balance of the two programmes has shifted significantly in favour of disability benefit spending, which is three times greater than spending on poverty.

The means-tested social assistance programme has declined considerably, leading to a relative weight of 0.025% of GDP in 2018. The system has been thoroughly reformed since 2012, with the aim of improving targeting and administrative efficiency, and reducing fraud. Concerns persist in terms of its coverage and, in particular, the relatively small amount of benefits. The size of benefits in the poverty-targeted programme needs to be revised in line with minimum living standards.

Spending on the disability programme accounted for 1% of GDP in 2018. During the period 2005-2018, both the number of beneficiaries and the size of benefits increased significantly. The disability programme is undergoing a thorough reform, aimed at moving it away from the traditionally strictly medical evaluation to broader considerations of social and psychological factors associated with disability, and at improving the targeting, effectiveness and efficiency of the eligibility evaluation process.

The size of activities related to employment is very small, at about 1.4% of total social protection spending, and no substantial increase is projected for the medium term. Labour market indicators have consistently improved, but unemployment remains high, at 12.3% in 2018, in particular for youth aged 15-29 (23%). Female participation rates in the labour market have increased – from 53% in 2010 to 58% in 2017 – but remain low. Active labour market policies accounted for more than half of total spending on employment in 2018 (including administration costs) and have garnered intensive government focus, while unemployment benefits make up 34% of total spending. Spending on active labour market programmes has significantly increased in recent years, slightly crowding out spending on passive employment measures; meanwhile, a number of policy measures aimed at ensuring better linkages with skill development,

labour demand and particular attention to the most vulnerable groups have been undertaken since 2015. The coverage rate and size of unemployment benefits is very limited.

Government revenue finances more than half of social protection spending. The fiscal revenue structure relies heavily on indirect consumption taxes. The Albanian fiscal system has contributed to a reduction in inequalities; however, a moderate poverty-increasing effect was observed in 2015.

1 Current levels and past changes in financing social protection

Albania's overall social protection spending is significantly lower than the EU average, although it more than doubled between 2005 and 2016. In 2016, Albania spent 9.4% of its GDP on social protection, much lower than the European average of 28%.¹ The fastest growth in social protection spending occurred between 2010 and 2016, when the relative weight of social protection to GDP rose by 1.2% in nominal terms and 1.1% in real terms (Table 1). Notably, social protection expenditure grew by an average of 10% annually, more than tripling in real terms between 2005 and 2017.

Social protection spending is dominated by social insurance outlays, which account on average for over 75% of total spending in all years. One of the underlying reasons for the relatively low levels of spending on social protection is the low level of pension benefits, which is the programme with the highest population coverage. The other two main programmes in social protection are the social assistance and the employment assistance programmes (both active and passive), with relative weights of 17% and 1.3% on average during the period 2005-2016. The budget for the sector has increased across almost all programmes. The increase is mainly driven by the pension fund (biggest relative weight), cash programmes in social assistance, and labour market and vocational education programmes.

Table 1 Gross expenditure on social protection in % of GDP

Year	Social Protection Spending (million EUR)	Spending (% of GDP)	
		Current prices	Constant prices, 2005=100
2005	490.0	7.6%	7.6%
2006	559.3	7.9%	7.6%
2007	624.8	8.0%	7.5%
2008	701.8	8.0%	7.2%
2009	717.1	8.2%	7.3%
2010	741.2	8.2%	7.3%
2011	766.5	8.3%	7.4%
2012	822.0	8.6%	7.8%
2013	880.9	9.2%	8.4%
2014	920.8	9.2%	8.4%
2015	938.9	9.1%	8.3%
2016	1015.0	9.4%	8.4%
2017	1074.5	9.3%	8.1%

Note: For 2009, social protection spending data is from the Ministry of Finance of Albania (Normative Act December 2009 and 2009 Budget Outturn Law) and does not include local government spending. The above figures do not include the public Compulsory Health Insurance Fund contributions, which would account for another 1.2% of GDP (on average) in nominal terms. The exchange rate for the Albanian Lek is based on the official EU Commission average monthly exchange rate for each year (InforEuro database).

Source: Own calculations, based on IMF data.

¹ European System of Integrated Social Protection Statistics (ESSPROS).

The pension system in Albania consists of a compulsory pillar – a public universal-coverage social insurance system – and a private voluntary supplementary pillar.² The public pension system is managed as a special single fund within the budget of the Republic of Albania, administered by the Social Insurance Institute (SII) and is responsible for paying retirement (old age), disability and survivor benefits to contributors; it also provides coverage to contributors in the event of illness, unemployment, accidents at work and maternity. The public social insurance scheme encompasses a mandatory insurance scheme (universal coverage for urban and rural contributors); a voluntary insurance scheme; supplementary schemes for higher functions in the public administration and military; and merit pensions for war veterans and persons who suffered political persecution. The supplementary schemes are financed entirely by the state budget. Since the pension system reform of 2015, a social pension programme is also included.

Spending on pensions is relatively low, at an average of 6.8% of GDP over the period in question; however, it has risen in both nominal and relative terms – from ALL 49 billion in 2005 (EUR 394 million) to more than ALL 119 billion in 2017 (EUR 888 million, or from 6.4% of GDP to 7.7% of GDP). The pension system in Albania is based on the pay-as-you-go (PAYG) principle. In 2014, a pension reform was undertaken, in order to address the growing fiscal pressures and rising deficits of the scheme.³ These were exacerbated by changes in the demographic structure and decreasing levels of contributors (also due to high levels of labour informality).⁴ The changes introduced to the scheme aimed at enhancing employee incentives to contribute, by increasing the rate of return on contributions (i.e. lifting the previously stringent caps on maximum pension benefits) and gradually increasing the retirement age for both women and men to 67 years of age, with a contribution period of 40 years for all full pensions by 2056. Contributors are entitled to a partial pension upon completion of the contribution period if they are no longer active (i.e. not in employment or self-employment). A means-tested social pension was also introduced in 2015 for those aged over 70 who are not otherwise eligible for the system. As a result of the reform, fiscal sustainability of the pension scheme has gradually improved; this is complemented by an increase both in the number of contributors and in the pension amount.

Fiscal sustainability of the social insurance system has improved over recent years. The fiscal deficit of the scheme is gradually decreasing, although it remains high, at 1.8% of GDP.

² The private pension pillar is relatively underdeveloped, but is growing steadily. By the end of 2017, three voluntary private pension funds were operational in Albania, with a total of 20,947 contributors and with net assets of 1.73 million Albanian Lek (ALL).

³ The pension scheme was balanced until the mid-2000s, despite undergoing considerable fiscal stress due to an ageing population, migration and low incentives to contribute to the scheme, given the low rates of return, in particular for high earners. The budget deficit of the pension scheme started rising from 2005 and warranted the pension reform of 2014.

⁴ See, for instance, World Bank (2013). Between 2006 and 2010, the number of contributors as a share of the working-age population was only 22% total, and 18% for the urban areas (most of contributions for rural pensions are paid by the government). In addition, several reports highlight the relatively low levels of participation in formal labour in Albania. The International Labour Organization (ILO) reports that informal employment in Albania was as high as 33% of total employment in 2013 (based on Labour Force Survey (LFS) data), while World Bank (2018) indicates that informal labour increased in nominal terms during 2018.

Table 2 Social insurance scheme indicators

Year	Contributions (million EUR)	Pension benefits ¹ (million EUR)	Pension scheme deficit (in % of pension spending) ¹	Pension deficit (in % of GDP)
2005	270.4	331.3	18%	0.94%
2006	289.9	370.3	22%	1.13%
2007	303.6	395.9	23%	1.18%
2008	347.4	437.6	21%	1.02%
2009	336.4	463.0	27%	1.45%
2010	328.2	476.9	31%	1.65%
2011	345.1	497.2	31%	1.64%
2012	354.6	533.5	34%	1.86%
2013	366.4	567.8	35%	2.09%
2014	441.3	609.9	28%	1.69%
2015	430.7	636.6	32%	2.00%
2016	483.9	681.3	29%	1.84%
2017	548.6	747.1	27%	1.71%

Notes: 1) The figures above refer to the compulsory benefit scheme (old age, and temporary disability, maternity) and do not include supplementary programmes that are fully funded by the state budget, such as supplementary pensions, merit pensions or price compensation programmes. If these are taken into account, the deficit is higher. The Exchange rate for the Albanian Lek is based on the official EU Commission average monthly exchange rate for each year (InforEuro database).

Source: For pensions: SII. For GDP: IMF data.

The social protection system in Albania provides coverage to almost half of the population. The social insurance system used to have a very strong income-redistributive character, particularly until the reform of 2014. This involved a high minimum pension (relative to the minimum wage) and generous rural pensions that were not linked to the size of contributions and had developed into a form of social assistance benefit.⁵ The other major social protection programmes with extensive coverage include the means-tested poverty-alleviation programme (social assistance) and disability benefits. The relative balance of these two main non-contributory transfer programmes has shifted significantly. The relative weight of old-age pensions has consistently increased, while spending on means-tested benefits has gradually declined since 2012, alongside similar declining trends in spending on labour market policies and social care services (Table 3).

⁵ Some 20% of the population receives benefits from the pension scheme. Estimates based on the Living Standards Measurement Study (LSMS) 2008 indicate that at least 45% of the population live in a household that receives pensions (World Bank, 2010).

Table 3 Relative weight of social protection spending, by function

	2010	2011	2012	2013	2014	2015	2016	2017
Illness/disability	18.1%	18.2%	18.4%	19.9%	21.4%	19.1%	18.4%	18.5%
Old age	63.7%	64.8%	64.3%	63.3%	63.9%	66.5%	68.0%	68.4%
Survivor	4.1%	4.0%	3.7%	3.5%	3.2%	3.1%	2.9%	2.8%
Maternity/child benefit	1.5%	1.8%	1.8%	1.9%	1.9%	1.9%	1.9%	2.1%
Means tested	4.6%	4.3%	3.8%	3.5%	3.7%	3.4%	3.3%	3.4%
Unemployment	1.6%	1.4%	1.4%	1.1%	1.3%	1.2%	1.3%	1.0%
Social care services	2.7%	2.8%	3.7%	3.6%	2.4%	1.8%	1.5%	1.1%
Social n.e.c.	2.2%	1.3%	1.3%	1.6%	0.8%	1.4%	1.3%	1.2%
Administration	1.4%	1.5%	1.5%	1.6%	1.4%	1.5%	1.6%	1.5%

Note: Illness/disability expenditure includes disability benefits from both contributory and non-contributory programmes.

Source: Own calculations based on Ministry of Finance/Treasury data.

The social insurance programme plays the role of a social assistance scheme for a number of population categories, in particular rural contributors. The lion's share of spending on the social insurance scheme goes on old-age pensions (81% in 2017), while an additional 2.9% is spent on maternity benefits and temporary disability pensions, and on work-related illness. Special pensions and government compensation programmes account for 4% and 10% of total expenditure, respectively, while administration costs amount to 1.8%. The system, as established in 1993, inherited two separate pension schemes – one for employees of state enterprises and one for agricultural cooperatives. Contributions for rural pensions were kept at a minimum, due to social considerations; meanwhile the size of rural pensions increased over the years much more rapidly than urban pensions. In 2013, rural pension contributions amounted on average to 53% of urban pension contributions, yet they covered only 19% of rural pension benefit spending. Eligibility for rural pension benefits was also tied to a minimum working period of 17.5 years, which discouraged longer participation in the scheme.

The means-tested social assistance programme has declined in relative terms, from a relative weight of 0.04% of GDP in 2005 to 0.025% by 2018. In nominal terms, the total funding pool for the social assistance programme has fluctuated over the years, and was estimated at EUR 32.3 million in 2018, up from EUR 25.7 million in 2005. The social assistance scheme is the only poverty-alleviation programme in the country. The system was thoroughly overhauled after 2012, with the aim of improving targeting and administrative efficiency, and reducing fraud. A proxy means-tested scoring formula was introduced for the evaluation of eligibility in 2013. The new system was rolled out nationally in 2018, following piloting in three regions over a three-year period. The revised programme has addressed elements of transparency, corrupt practices and subjectivism. Nevertheless, concerns persist in terms of its effectiveness in targeting the poor and in particular the relatively small amount of benefits. The size of benefits has increased slightly following implementation of the reform. The number of households eligible for benefits decreased considerably over the period – from over 118,000 households in 2005 to 80,000 in 2016.

Table 4 Non-contributory social protection (SP) transfer programmes

Year	Means-tested benefits (social assistance – poverty)			Disability benefits		
	No. of beneficiaries	% of SP spending	% of GDP	No. of beneficiaries	% of SP spending	% of GDP
2005	505,220	5.3%	0.40%	--	10%	0.7%
2006	478,183	4.6%	0.35%	53,000	11%	0.8%
2007	406,489	2.9%	0.23%	55,754	15%	1.2%
2008	401,342	4.3%	0.34%	57,333	13%	1.0%
2009	412,189	4.2%	0.35%	129,076	11%	0.9%
2010	411,128	3.4%	0.28%	132,687	13%	1.0%
2011	417,230	3.4%	0.28%	142,243	12%	1.0%
2012	414,895	3.2%	0.27%	124,500	12%	1.0%
2013	436,201	3.8%	0.34%	--	12%	1.1%
2014	327,880	2.7%	0.26%	--	13%	1.2%
2015	331,252	3.1%	0.29%	156,934	10%	0.9%
2016	327,735	3.0%	0.28%	--	11%	1.1%
2017	--	3.4%	0.32%	--	10.90%	1.0%
2018	--	--	0.25%	--	--	1.0%

Source: Own calculations based on: INSTAT for data on beneficiaries of means-tested programmes (number of beneficiaries indicates the total number of individuals in households receiving benefits); State Social Service data on number of beneficiaries for disability benefits, which include both people with disabilities and caregivers, as applicable. Spending on programmes: data from Ministry of Finance (Boost database for 2010-2016 and budget outturn data for 2005-2009).

Spending on the disability programme accounts for more than four times the spending on the social assistance scheme (ALL 16.4 billion or EUR 129 million in 2018). During the period 2005-2016, both the number of beneficiaries and the size of the disability benefits increased significantly, leading to total (non-contributory) disability programme spending of more than 1% of GDP in 2018. The disability programme is undergoing a thorough reform, aimed at moving it away from the traditionally strictly medical evaluation to broader considerations of the social and psychological factors associated with disability, and at improving the targeting, effectiveness and efficiency of the eligibility evaluation process.

The size of activities related to employment is very small, at about 1.4% of total spending, and no substantial increase is projected for the medium term. Labour market indicators have improved, but unemployment remains high, at 12.3% in 2018, in particular among youth aged 15-29 (23%). Participation rates of women in the labour market increased from 47% in 2010 to 51.4% in 2018, but remain low. The employment sector has received increased government focus in recent years. Until 2014, passive unemployment benefits constituted more than half of spending on the labour market programme, but these had declined in relative terms to 38% by 2016. The government has since re-evaluated the approach and increased spending on active labour market programmes, including on a number of measures aimed at ensuring better linkages with skill development, labour demand and particular attention to the most vulnerable groups.

Social and health insurance benefits, as well as other social protection receipts (social assistance, unemployment) are tax exempt in Albania.

2 Current mix and past changes in the sources of financing social protection

The structure of the financing mix in social protection has been stable over the past decade. However, deep reforms have been undertaken in each of the three main programmes (insurance, social assistance and disability) in recent years, with the aim of improving fiscal sustainability and the targeting of the programmes. More than half of social protection receipts in Albania are financed through social contributions (2017). The general government contribution amounts to 49% of total spending, or 32% of financing for the Social Insurance Fund, which covers contributions paid by the government for specific categories, special government programmes, and financing the deficit of the public insurance scheme. The remaining general government contributions finance non-contributory programmes, such as poverty and disability cash benefits, labour market-related programmes, and social care services.

Table 5 Social protection spending by source of financing

	2005	2008	2010	2015	2016	2017
Social Insurance outlays	80.4%	76.4%	77.7%	81.8%	82.1%	82.7%
Social contributions	51.9%	45.1%	44.3%	45.9%	47.7%	51.1%
General government contributions	48%	55%	56%	55%	53%	49%
Of which: GG transfers to Social Insurance Fund	29%	31%	33%	36%	34%	32%

Source: Own calculations, based on IMF data for social protection spending; for 2009 social protection spending data is from the Ministry of Finance of Albania (Normative Act December 2009 and 2009 Budget Outturn Law) and does not include local government spending; SII for composition of source of financing of social insurance outlays.

The 2014 pension system reform strengthened the contributory principle of the system and reduced its redistribution features, in order to provide incentives for participation. Prior to the reform, the compressed size of the benefit – with little difference between the minimum and the maximum pension levels – led to a weak linkage between size of contributions and benefits, further undermining any incentive to participate. The pension replacement rate increased slightly, from 43.1% in 2014 to 46% in 2016 for urban old-age pensions; and decreased slightly, from 43.8% to 41.4%, for rural old-age pensions in the same years.

Currently the social insurance contribution rates amount to 24.5% of gross monthly incomes; of this 13.8% is paid by employers and 9.5% by employees.⁶ Social insurance contributions are payable on the gross income, up to a ceiling that is about four times the minimum wage and that is adjusted periodically. Self-employed persons pay contributions based on the minimum wage; meanwhile the size of contributions for citizens in rural areas is set at between 44% and 58% of urban self-employed contributions, depending on location. In 2016, the system dependency ratio was 0.84 (84 pensioners per 100 contributors).

⁶ Employers' contribution rates have been revised several times: from 29.9% of gross salaries in 2005; to 23.9% in 2006; and 13.8% in 2009. The employer pays an additional 1.2% of gross salary for work-related accident and illnesses (0.3%) and for unemployment (0.95%).

Table 6 Pension scheme coverage and dependency rate, 2011-2016

Year	No of rural contributors	Rural pensions	Dependency rate: rural pensions	No. of urban contributors	Urban pensions	Dependency rate: urban pensions	Coverage rate (total)
			Beneficiaries/c contributors			Beneficiaries /contributors	Contributors /working-age population
2011	261,097	157,719	60%	431,013	394,042	91%	51%
2012	168,513	154,143	91%	434,891	399,959	92%	47%
2013	205,234	152,024	74%	438,170	418,399	95%	55%
2014	127,728	149,146	117%	480,791	436,337	91%	50%
2015	89,527	144,769	162%	579,087	454,163	78%	53%
2016	53,168	139,154	262%	608,487	472,390	78%	51%

Note: The number of contributors includes direct contributors only, and does not account for contributions paid by the state budget for supplementary schemes.

Source: Own calculations, based on SII data and Institute of Statistics (INSTAT) Labour Force Survey (LFS) for working-age population.

A social pension was introduced for the first time in 2015, to safeguard the interests of the elderly population in need. The social pension is equal to the minimum partial pension benefits at the minimum wage, for a contribution period of 15 years. Residents of Albania with income below the social benefit are eligible for the social pension. In 2015 and 2016, 1,775 and 2,415 persons, respectively, benefited from the social pension; total spending was ALL 99 million and ALL 140 million in 2015 and 2016 (709,000 and EUR 1 million), respectively. The maximum size of the social pension is higher than the average social assistance benefit for a four-member household; however, it remains precarious.

The insurance scheme pays out for a number of price-compensation programmes financed by the state budget. In the period 2010-2015, these programmes accounted for between 10% and 11% of the total spending of the insurance fund, decreasing to 8.8% in 2016. Pensioners retiring from 2015 are not eligible for the price-compensation programmes.

Maternity benefits are relatively generous in Albania, with a coverage period of 365 calendar days, of which 35 days are pre-birth and a minimum of 63 days are post-birth. Women with a minimum contribution period of 12 months are eligible for maternity benefits, which equal 80% of the contributory salary for the pre-birth period and 150 days post-birth; and 50% of the contributory salary thereafter. Since 2015, men have also been eligible for paternity benefits, which start 63 days after the birth of a child; after that, they enjoy the same rights as women, provided both parents do not receive benefits simultaneously. Maternity contributions account for 1.4% of total contributions and cover 34% of maternity benefits.

The means-tested social assistance cash benefit is the only family benefit in Albania, targeting households and special categories of individuals in need. It pays a flat amount, based on the household structure, and is capped at a maximum of ALL 9,000 (approximately EUR 70) for households of six or more members. The average size of benefits for a four-member household, with two adults and two children, is ALL 4,560 (EUR 37). The number of eligible households on the programme has shrunk considerably in recent years, while reform of the administration has aimed at improving targeting and increasing transparency. World Bank studies indicate that targeting of the programme has improved, with 75% of total spending going to the poorest 40% of households; the social assistance programme contributes to reducing poverty by a maximum of 0.8

percentage points.⁷ Nevertheless, the size of benefits paid by this, the only poverty-targeted programme, is very low and is not tied to a minimum living standard, which was estimated at ALL 16,000 (EUR 116) per person per month in 2016 (ACER, 2016). The monthly minimum wage in Albania in 2019 is 5.7 times the average cash benefit for a four-member household.⁸ In 2005, the absolute poverty rate in Albania was 17.3%; this declined significantly in 2008 to 12.5%; but by 2012, poverty had risen again to 14.3%.⁹ Poverty is estimated to have declined in recent years, as economic growth and employment have risen.

There are no child benefits in Albania, with the exception of a one-off bonus payment at birth. The revised social assistance programme also provides modest top-ups to poverty cash benefits, in the form of cash transfers conditional on child school enrolment and vaccination,¹⁰ as a measure to ensure inclusivity for certain vulnerable categories. In January 2019, the government increased the infant bonus by 40 times for a firstborn child; 80 times for the second born; and 160 times for a third-born child.¹¹ Spending on the child bonus is financed through the state budget and is expected to amount to ALL 2 billion, or 0.4% of the general government budget in 2019. Also, Albania does not have any tax allowance programme for families.

The disability benefit has a stronger poverty-reduction impact than does the poverty-targeted programme, possibly due to its much higher level. The size of disability benefits (non-contributory cash programme) almost tripled in nominal terms during the period 2005-2016 (from ALL 5.8 billion to ALL 15.8 billion). Disability benefits are an income-substitution programme for those people who are otherwise unable to work due to their disability. However, the programme plays the role of a poverty transfer, by reducing poverty by 1.2 percentage points.¹²

Spending on unemployment benefits has decreased considerably, from an average of ALL 920 million between 2005 and 2013, to ALL 617 million in 2014 and ALL 335 million in 2016. Unemployment benefits are contributory benefits, paid to unemployed persons with a minimum contribution period of 12 months. The benefit provides coverage for a maximum of one year for unemployed persons with the maximum contribution period (i.e. 10 years). The benefit is quite low, at ALL 12,000 (EUR 97) a month in 2019 (or less than half of the minimum wage), even though it has increased significantly over the years. Coverage of the unemployment benefit programme is very limited: 2.2% of registered unemployed, or 1,900 jobseekers in 2017, and has declined considerably from 7.6% in 2010. The low number of beneficiaries is likely due to the fact that many unemployed do not meet the eligibility requirements (i.e. minimum contribution period), have exhausted the benefit entitlements in the case of longer-term unemployment, or do not register as unemployed.¹³ The decline in passive employment measures has been accompanied by an increase in spending on active labour market measures, thus preserving the spending on employment programmes at a fairly constant level. Labour

⁷ In Davalos et al, World Bank (2018) *Distributional impact of Albanian Fiscal System* it is argued, based on the Household Budget Survey of 2015, that 53% of the poverty programme goes to the bottom (poorest) quintile, and 75% goes to the bottom 40% of the distribution. Leakage is low, with only 4% of spending going to the highest-earning household quintile.

⁸ The minimum monthly wage in 2019 is ALL 26,000 (EUR 209), up from ALL 24,000 in 2018.

⁹ Institute of Statistics (INSTAT), based on the LSMS 2005, 2008 and 2012. Extreme poverty rates were respectively 3.3%, 1.2% and 2.3%. No poverty data is available for Albania from 2012. INSTAT has implemented the Survey of Income and Living Conditions (SILC) since 2016, but the results for 2016-2018 will only be published for the first time in mid-2019 (including relative poverty).

¹⁰ ALL 300 (EUR 2.4) per child.

¹¹ Respectively ALL 200,000 (approximately EUR 1,610), ALL 400,000 and ALL 800,000. Before 2019, the child bonus was flat at ALL 5,000 for every newborn child.

¹² In Davalos et al, World Bank (2018) *Distributional impact of Albanian Fiscal System*.

¹³ The number of registered unemployed has also decreased significantly in recent years; this is due both to an increase in employment and to the fact that many unemployed do not find the benefits attractive enough to bother registering. See also ILO (2017).

market indicators have improved, with unemployment rates decreasing. Nevertheless, the labour market suffers from a series of structural factors, including relatively high levels of inactivity – 40.6% in 2018, in particular among women (48.6%) – and high youth unemployment (25.8% in 2017). Unemployment benefits are administered separately from the Social Insurance Fund, with a central government executive agency in charge of payments and no apparent linkage between the two.

The government is considering in 2019 levying an earmarked ‘disability quota’ tax on employers who do not comply with the statutory requirement for the employment of people with disabilities. Revenue from the tax will be earmarked for labour market activation measures for the same category.

Social care services lack a clear institutional and financial framework, and instruments for the delivery and financing of social care services have not been spelled out clearly. Coverage of social care services is traditionally very limited in the country. The concept of a Social Fund for financing social care services at the local level was adopted in the legal framework as early as 2005, but has never been implemented. During 2018-2019, the government has been developing a new approach for resourcing and allocating the Social Fund to local government units, which have primary responsibility for service provision. The size of the fund is modest, at an estimated ALL 150 million in 2015. Traditionally, spending on social care services has been very low, at less than 5% of spending for the two non-contributory cash programmes. The majority of services are provided by the non-public sector and funded by donors or charities.

Development of a strong system for the delivery and financing of social care services is strongly interdependent on reforms in the social assistance and disability benefit programmes, which rely heavily on the existence of service provision to cater to households that fall outside the scope of the poverty-targeted programme; as well as the need to provide rehabilitation and integration services for people with disabilities.

3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic

The social protection system in Albania has strong redistributive effects. The social insurance scheme is the largest programme in social protection spending and is financed largely by direct contributions (58%). The 2014 reform of the pension system aimed at gradually reducing the distributional character of the scheme, in order to increase the incentive to contribute for more years and to declare full earnings. The fiscal deficit of the scheme is gradually declining, due to an increase in the number of contributors and a rise in the retirement age for both women and men. The pension replacement rate is now more directly linked to the size of benefits, in particular for middle- and high-income individuals. There is a cap on the maximum contributory salary, which is adjusted periodically with the increase in the minimum wages. Nevertheless, long-term projections indicate that the scheme may undergo fiscal stress further down the way, due to the rapid ageing of the population and higher benefits.

The general government finances 53% of social protection spending, amounting to ALL 73 billion in 2016, or 4.9% of GDP. Of this, 27% goes to finance the deficit in the pension scheme, and 41% finances the supplementary pension schemes and government compensation programmes. The Albanian fiscal system relies heavily on indirect taxes, which made up 42% of total revenue in 2016 (VAT 32% and excises 10%). Since 2014, a progressive personal income tax system has been in place, with rates of 0%, 13% and 23% levied on different income levels. Revenue from personal income taxes accounted for only 7.7% of total budget revenue in 2016. While it may be argued that the progressive tax system contributes to reducing inequalities and has the desired redistributive impact, it may equally create disincentives for the formalisation of employment or the declaration of full earnings. This may not only undermine the fiscal sustainability of the pension scheme and increase pressure on the general government budget, but may also lead to increased precariousness and vulnerability in the labour market.

The level of benefits under the poverty-targeted programme needs to be revised in line with minimum living standards. Current benefits are extremely modest and cannot guarantee dignified minimum living conditions. Spending on the social assistance programme needs to increase, possibly by redirecting the savings produced by declining pension deficits in the medium term. This should be done by further consolidating the improved administration and targeting of the programme, while gradually reducing the number of eligible households.

Welfare and labour market programmes need to be better harmonised, by ensuring linkages between passive assistance schemes (such as the social assistance and disability programmes) and activation measures (employment-promotion programmes). Unemployment benefit coverage and benefit levels need to increase to provide an opportunity for the unemployed to look for appropriate employment. Unemployment benefits may need to be better linked to the previous earnings or contributions of the unemployed, and better tied in with active labour market policies, including job mediation and skills development. Improving the outreach and coverage of social care services is a key missing link in the system: the latter are not only essential to the most vulnerable categories (including, but not limited to, people with disabilities), but may also provide important support for increased rates of labour market participation, in particular for women. Studies indicate that the lack of child-support services is a key deterrent to women's employment. Spending on social and childcare services needs to increase, and the government needs to develop a transparent, equitable and predictable financing mechanism for social services at the local level.

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