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Fiscal Sustainability – A Review on Pension System

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ABSTRACT

Fiscal sustainability represents one of the primary objectives for policymakers worldwide. Debates on how to achieve and maintain fiscal sustainability are always present in the governments' agendas and are also a crucial topic in the academic world, especially in the Public Finance field. This study has focused on the fiscal sustainability and its linkage with the pension's programs. It presents the pension challenges from the perspective of the WB6 countries and it compares with the most developed economies. A broader focus was given to Kosovo, a state in WB6, which represents a unique case in WB6 due to the demography structure and challenges regarding the pensions. In Kosovo the pension system of elderly people is characterized as discriminatory and concrete steps need to be taken in order to be reformed. Furthermore, Kosovo needs to take advantage of the youth and create strategies to offer better opportunities to keep them in the country.

1. Introduction

Fiscal sustainability represents one of the primary objectives for policymakers worldwide. Debates on how to achieve and maintain fiscal sustainability in one hand and to support economic growth on other hand are always present in the governments' agendas. Meantime they are also a crucial topic in the academic world, especially in the Public Finance field. Considering the fact that fiscal sustainability is defined as the ability of the governments to harmonize public expenditures and public revenues, it is obviously clear that the importance of this process is crucial for the state's existence. Nowadays public expenditures are seen as an important hub, through which public revenues are not just spent, but are oriented in favor of economic development and social welfare (Bexheti, 2007), and as a consequence, the process of the planning of public expenditures is being more challenging. While governments create strategies to plan and to control public expenditures, the challenge to implement these strategies is getting bigger and harder. This is because public expenditures have experienced a rapid increase in recent decades, sometimes putting at risk the base of the mixed economy (Konxheli, 2019). The increase of public expenditures is happening especially due to the post COVID-19 time, energy crises caused by the unprovoked Russian invasion in Ukraine and meantime expenditures are used as political instruments by governments to accomplish their electoral agendas. On the other hand, public revenues cannot be increased every time that in the state exists needs for public expenditures, because reforming the taxation system is not a simple task (Hyman, 2014). Saying this it is obviously clear that fiscal sustainability is a very complex and multidimensional process. Hyman (2010), pointed out that the state cannot be run like a business, because states do not sell products for profit, governments do not face competition and governments' projects and programs are often chosen through political processes. These points make the process of fiscal sustainability more challenging and at the same time attractive for studies.

Important segments with a significant impact in fiscal sustainability are especially social funds. Recently in the literature is found an increased interest to study the impact of social funds in fiscal sustainability especially after the crisis of 2008. Social funds provide revenues in the form of pensions and health benefits financed by taxes to eligible persons (Hyman, 2014). According to Hyman (2014), in the United States of America (USA) in 2012 were approximately 53 million people who benefited from pensions and 40 million people from health benefits. Approximately 70% of people who benefited from pensions were retired workers and others were disabled workers (Hyman, 2014). On the other hand, health benefits are offered also to some children in households with low revenues (Hyman, 2014).

Bexheti (2020), has presented a graph of public social expenditures as a percentage of GDP in OECD countries for the period 1960-2018. The average in OECD countries is approximately 20% of GDP. From the figure we can see that the highest percentage is in European countries while the lowest percentage is in Latin

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America. The figure also shows that there is an increasing trend of public social expenditures over the last decades and authors worldwide in their studies have expressed their concerns about this situation. Hyman (2014, 2010), Ihori (2017), Bexheti (2007, 2017), Abazi – Alili et al. (2018), Alija et al. (2019) and Alija et al. (2021), pointed out that the percentage of elderly (65 and over) people in the population is increasing and the pensions will have greater demands. On the other hand, tax paying workers' percentage in the population is declining and the states will face challenges on how to cope with population aging and how to achieve and maintain fiscal sustainability in a very challenging future of social funds? Authors mentioned above have proposed reforms to deal with the mentioned above challenges, which will be discussed further in the section of literature review.

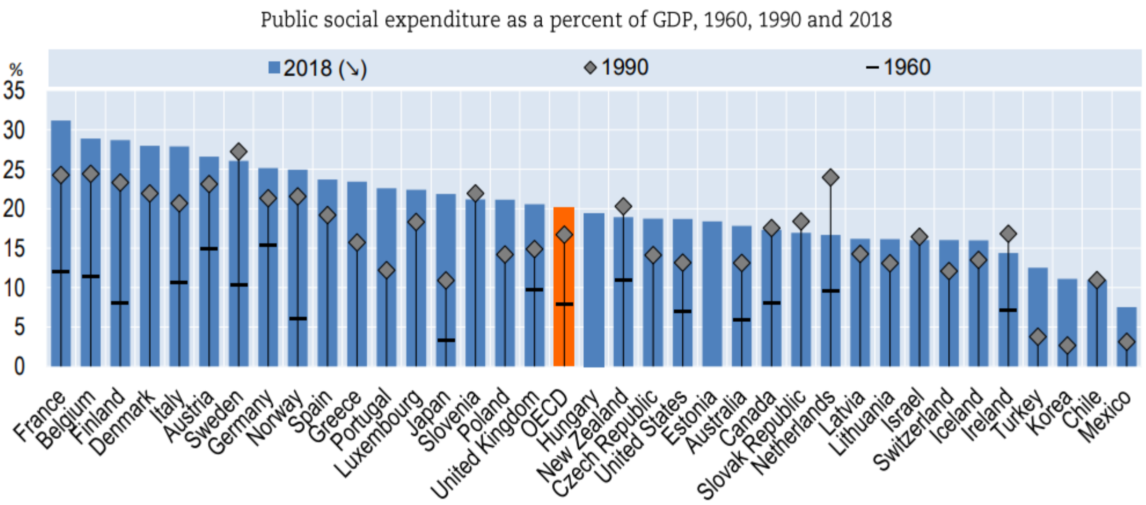

Figure 1. Public Social Expenditures as a % of GDP in OECD Countries (1960-2018)
Source: Bexheti (2020) & OECD (2019).

Bearing in mind the importance of reforms in social funds to achieve and to maintain fiscal sustainability, this study will have a focus on this topic from the perspective of pensions schemes in Kosovo a country in Western Balkans 6 (WB6) region. The author has chosen Kosovo, because Kosovo represents an unique case with an urgent need to consider reforms in pension programs. Reforms are needed to eliminate inequality between citizens and also to create opportunities for fiscal sustainability. Pension system in Kosovo has started implementation in very challenging times, in post the war period and a lot of gaps and obstacles are present. Therefore, the study aims to offer a long-term solution for social funds – pensions in Kosovo to achieve and to maintain fiscal sustainability. To achieve this aim, the author will present best practices from the USA, Europe and WB6. This study is organized as follows: the next part will bring the existing literature about the main topic of this study. The third part will present an overview of Kosovo's pension funds, will identify main gaps and will propose models to reform pension funds. The fourth part will draw conclusions.

2. Literature review

As was mentioned in the introduction part, the authors worldwide have a huge interest in studying the relationship between fiscal sustainability and social funds. In fact, this topic is characterized as one of the main issues in the Public Finances field. When it comes to the social funds reforms, authors worldwide share the same opinion: there is an urgent need to reform social funds. The real debate starts at the point on how to do this reform? Authors have proposed different solutions, but the biggest debate lies in the adoption of public funds or private funds? This section will present different works that have contributed to this debate and will summarize findings of these studies.

When fiscal sustainability and pensions are studied, it is almost impossible not to mention the work of Professor David N. Hyman. Hyman, in all 12 editions of his book "Public Finance – A contemporary application of theory to policy" has treated this topic as one of the most important matters for state existence. Hyman (2014), has presented social security programs in the USA and European Union (EU), including challenges and perspectives. Meantime Hyman (2014), has made proposals to reform social security systems in these countries. According to Hyman (2014), social security programs in the USA include schemes such as pensions, unemployment compensation, disability payments and health compensation. The most important programs with a considerable participation in public expenditures are pensions. He mentioned two forms of pensions: fully funded systems (people during their work, save by themselves for their retirement) and pay as you go (the current working generation through their taxes pay pensions for retirees). Hyman (2014), pointed out that in the USA a "pay as you go" pension system is applied which is collected from the payroll tax to provide pensions to aged people. This system works in that way by transferring taxes from those who work to the retired people. Hyman (2014), called this way of functioning as a "contract", between workers and retired people. This system used to be a good one, but in recent decades a lot of gaps have been identified on it. According to Hyman (2014), the aging population represents a big challenge, not just in the USA, but also all over the world. While the pay as you go system requires high tax rates to pay pensions, recently the number of workers is decreasing and on the other hand there is an increase of retirees. Hyman (2014), has presented the ratio of people 65 and older to those 15 – 65 years old in the biggest economies of the world which is presented in the next table.

Table 1. Ratios of people age 65 and older to those ages 15-64 for 7 leading industrial nations in the world

Country	2000	2010	2030	2050
Canada	18	20	38	44
France	25	26	42	47
Germany	24	31	45	50
Italy	27	32	49	69
Japan	25	35	52	71
United Kingdom	24	25	35	38
United States of America	19	19	31	33

Source: Hyman (2014)

Table 1 shows that aging is becoming a bigger problem from year to year. At the beginning of the century, the percentage of people aged 65 and older compared to those aged 15-64 was 18% (the lowest percentage) in Canada and 27% (the highest percentage) in Italy. However, projections indicate that by 2050, in the middle of the century, those percentages will rise to 33% (the lowest percentage) in the USA and 71% (the highest percentage) in Japan. These projections suggest that the pay-as-you-go pension system will not be feasible in the coming years. In the table are also presented the main EU countries and we can see that the situation is not well either there. According to Hyman (2014), the EU has developed social politics for its citizens, because the period between the years 1960-1990 was characterized as a great period of economic development, but the 21st century has brought the aging problem also in the EU. While in 2010 the social funds in Europe averaged to 10.2% of GDP, the projections show that the percentage will rise to 23.9% in 2060 (Hyman, 2014). This situation makes pension schemes a great challenge for states to achieve and maintain fiscal sustainability, bearing in mind that the needs for expenditures exceed income sources.

Hyman (2014), in his book has proposed three options to overcome this challenge. Option called "Maintain Benefits", option two called "Individual Accounts" and option three called "Personal Security Accounts". The third option according to Hyman (2014), is the most radical proposal, which leads pensions in the direction of privatization, which did not work well in the United Kingdom due to failures in the transition process. Therefore, this option still remains a big option to consider if the transition process is done very carefully (Hyman, 2014). The three above options represent solutions to the aging problem and offer real opportunities for states to control public expenditures caused by pensions and at the same time are options to achieve and maintain fiscal sustainability.

Besanko & Malik (2017), have published a paper that addresses the aging problem of the USA and the fiscal sustainability challenge of pension programs. Authors mentioned above in their study have analyzed the pension reforms in Australia, Sweden and Mexico to compare and adopt best practices for the USA. Besanko & Malik (2017), have presented that the main reforms in Australia and Mexico include the adoption of private funds, while in Sweden the reforms include the adaptation of national defined contributions accounts combined with private funds. In this study it is pointed out that reforms in pensions can lead to fiscal sustainability regarding the aging problem. Policymakers just need to answer the questions about what needs to be done and when. Besanko & Malik (2017), pointed out that the USA could learn from the experiences of other countries in order to make private pensions funds a mandatory policy.

Ihori (2017), on the other hand, does not support the private funds of pensions. He treats pension challenges from the perspective of Japan and although he mentions the advantages of private pensions funds, he argues that public pensions are a must in each state. Ihori (2017), argues that the public pension system is necessary because it enables revenue redistribution while the private pensions funds are mentioned that have failed due to investments and different crises. According to Ihori (2017), revenue redistribution is not made just between generations, but also within generations, because contributions made by those who die earlier are transferred to those who live longer. Ihori (2017), suggests that the reform of pensions in Japan should include a transformation from a defined benefit system to a defined contribution system, but the pension funds should remain a public one not a private one. Similar thoughts are found also in the study of Williamson & Howling (2003). Williamson & Howling (2003), point out pensions cannot be an object of private funds because it is too risky.

While the experience of the countries presented above, treated the pension challenges from the aging perspective, the WB6 Countries (Albania, Bosna & Herzegovina, Kosovo, Montenegro, North Macedonia & Serbia), is a different case. In fact, the aging problem is present in this region, but not in the levels as in EU countries. A bigger problem that is constantly facing this region, which is linked directly with the pension schemes and increasing aging problem is the migration of young population. Just in the period between 01.03.2020- 31.12.2020 when the world was in lockdown due to COVID-19 Pandemic, Germany has issued 30200 working visas for the citizens of WB6 (Schengen Visa, 2021). This number is very high even in the normal situation, and extremely high in the above mentioned period since these working visas were issued during the lockdown period when economic activity was almost completely shut down.

The problem of the aging, migration and challenges of pension schemes in WB6 were treated in detail by Bexheti (2007, 2017) Abazi – Alili et al. (2018), Alija et al. (2019) and Alija et al. (2021). The authors mentioned above have the main focus in North Macedonia, but always make comparisons with the region and the EU. According to Bexheti (2007), North Macedonia is facing pension challenges due to the structural reforms that started in 1994 and continued in 2001 and in 2007. In 1994 retirement was more attractive than working, therefore a large number of workers moved to retirement. Before the year 2001, the retirement age for males with 15 years working experience was 61 years old and for females the retirement was 58 years old (Bexheti, 2007). After the year 2001, according to Bexheti (2007), in North Macedonia the retirement age for males rose to 64 years old and for females the retirement age rose to 62 years old (Bexheti, 2007). For both, males and females are a possibility to extend the retirement age up to 67, but Bexheti (2017), presented the projections for the next years of the ratio between retired people and young people and the data showed that situation in next decades will be challenging, because there will be more retired people than working ones. Except for the aging problem, North Macedonia and the whole as was mentioned region is facing a large number of migrations, therefore the government needs to plan and manage better social funds addressing the actual challenges.

Abazi – Alili et al. (2018), Alija et al. (2019) and Alija et al. (2021) have a great contribution on analyzing the sustainability of pension systems. With a focus in North Macedonia and in comparison, with transition countries, the above-mentioned papers have shed light on the challenges of pensions arguing that in cases of WB6, especially North Macedonia private pensions funds need to be implemented. In the above-mentioned papers is pointed out that in the last decade in the North Macedonia, more than 40% of the yearly budget planned for pension fund need to subsidize by the state budget which does not represent a sustain policy in long term. Regardless of the challenges that were mentioned above, the private pension funds are seen as a solution in the era of aging and migration.

To conclude we can say that pension schemes worldwide are facing different challenges. While in the most developed countries the debate is built on the need for private pension programs or public pension programs, since the world is aging, in the cases of WB6, aging has emerged as a result of large migration. We discussed in general the challenges facing WB6, in the next part we will discuss in detail pension programs in Kosovo. Kosovo, represents a unique case, first of all for demographic reasons and also for the challenges caused by the war.

3. Kosovo's pension funds – Challenges and Perspectives

As was mentioned above, Kosovo represents a unique case in WB6 regarding the pensions programs. It is unique, first because of demography, the amount of contribution to the pension fund, the way how the pension programs are functioning and due to the lower ratio between the active workers and retirees. Indexmundi (2020), has presented that elderly people (65 and more) in Kosovo made up 7.43 % of population, the lowest in WB6, but the trends are not showing a sustainable situation in this field since the migration is present also in Kosovo.

To start the discussions about the challenges of aging, migration and pension programs in Kosovo, we should note that Kosovo as a part of ex-Yugoslavia, did not inherit any policy from the old pensions system. In the administration of UNMIK, Kosovo started the first pillar of pensions in 2001 from zero. First pensions in 2001 included basic pensions for elderly people, which created inequality and discrimination because all people above 65 years old started to receive the same amount of pension. This amount was too low for the minimum needs for existence. This form of pension in 2001 did not count working experience of citizens and furthermore it is worth to mention that contributors in the ex-Yugoslavia system had lost their contributions and with no other option left started to receive the minimum amount of money that institutions in Kosovo in that time were able to offer. Now, in 2023, almost 24 years after the war, those contributions from Serbia are not back to the contributors yet. This problem is political now, and as long as this study do not focus in political challenges of Kosovo will not discuss furthermore this issue, but it is important to mention that the problem of the contributions in ex-Yugoslavia have created loses and have make elderly people poorer, because their work savings are still missing and their work experience did not count on the first pension system of Kosovo.

In 2001, was created the Kosovo Savings Pension Trust (KPST) as a second pillar of pensions. KPST is a mandatory plan to administer and to manage pension contributions until retirement (KPST, 2023), but a problem with KPST is that a lot of people who got retired in the first ten to fifteen years after the implementation of KPST received small amounts of money. A detailed analysis of the KPST program was made by Kllokoqi (2018), who pointed out that a Kosovar citizen needs to work more than 40 years to get a pension that will cover the needs for a normal life. This is because of the low salaries and the low contribution into the KPST fund. In Kosovo the amount of contribution to the pension fund is approximately 50% lower than the average of other Western Balkans countries and this fact is very challenging. Although the way how KPST is functioning is seen as a solution that addresses the challenges of pension schemes, in Kosovo this form is not efficient, therefore a change especially in the amount of contribution is needed.

First movements into the improvement of the pension system started to happen after the Independence of Kosovo in 2008. First pillar was improved with new categories of pensions. For the first time a new category of pensions was added for the people whose working experience until 1999 was at least 15 years. This was the first movement to reduce inequality and discrimination, but another problem started. Some citizens could not prove their experience before 1999. The regime in 1991 fired Kosovar people from the work and in that time Kosovar people created parallel institutions. During that period with the parallel system not every institution was able to record the experience of employers and again, a considerable number of elderly people were left without their pensions despite the fact that they have worked. This problem was present until 2023, and just in this year the Constitutional Court decided that the requirements for 15 years before the year 1999 are in contrary to the Constitution (Constitutional Court, 2022), but this decision does not regulate the missing information regarding the experience of citizens.

The Pensions system in Kosovo also includes the war category. This category includes families of war victims' pensions and war veterans' pensions. Families of war victims were easier to identify and the characteristic of this category is that it will be erased gradually. Beneficiaries of this pension are parents of the victim, spouses of the victim and children of the victim until 21 years old (Official Gazette of the Republic of Kosova – Law no. 04/L-054, 2011). The category of children is erased, because 24 years have passed since the war and the category of parents and spouses will be gradually erased with their death. A more complicated category is the veterans' category, because their identification was characterized with a lot of irregularity. The final list of veterans included fake veterans who have received pensions since 2015. Despite the fact that an investigation from the Special Prosecution had started in 2018, not much has been done. The pensions during this time were given to the veterans and just a few cases were identified as fake veterans. The cases of fake veterans are still being investigated, while the whole list of them has received their pensions for almost eight years. Another problem with veterans is that they can benefit from pension just if they are unemployed. With this condition the state has contributed in informal employment and also has contributed in the passivation of a considerable number of citizens because is more attractive to receive a pension for the whole life, than to seek for a job. There also other categories of pensions in Kosovo for the soldiers, miners etc., but those categories do not have great impact in public expenditures. The challenge is with the veterans' pensions and also with the pensions for elderly people.

From what was presented above, we can see that pensions challenges in Kosovo include first of all lack of planning and mismanagement. If the situation is looked from the fiscal policy side, we can see that in comparison with the Europe and WB6, Kosovo has the lowest expenditure in pensions, but those expenditures represent fiscal cost, because are covered in total amount from the budget, while in other countries the public budget finances just the deficits that cannot be covered by contributions (World Bank, 2020). Furthermore, the World Bank (2020), argued that the value of pensions has increased through the years and it is the time to make a strategy to face challenges and adapt best practices. Figure 2 shows the fiscal cost of pensions as a % of GDP in Kosovo. We can see that from 2014 there was a constant increase. In 2014, the government increased all pensions by 25%, and from the end of 2015, the government started to pay pensions for war veterans. Those movements have increased the participation of fiscal cost of pensions to GDP.

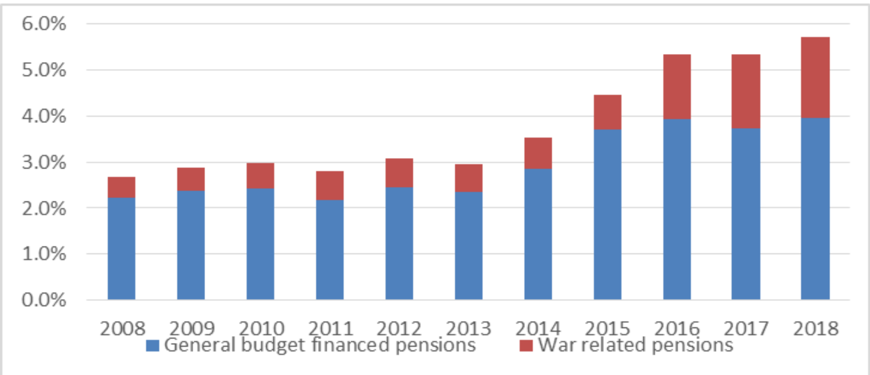

Figure 2. Fiscal Cost of Pension Benefits (as % of GDP)

Source: World Bank (2020).

While other nations are facing the aging problem, Kosovo is not dealing with it although the population is migrating. According to Eurostat (2019), Kosovo is the state with a great population shrink. Just in the last ten years Kosovo has experienced a population shrink from almost 15.4% (Eurostat, 2019). Different reports show that the shrink of population is caused due to migration, in the most cases from the youth.

So, first of all the government of Kosovo should take in consideration that the aging problem may come sooner than the data and projections shows. It is a fact that elderly people in Kosovo represent just 7.43 % of the population (Indexmundi,2020), but the trend of migration is increasing from year to year.

Second, the government should reconsider some changes in the Law for KPST and to combine the KPST pensions with the pensions financed by the budget. KPST is an institution with positive performance, the data show that this institution has managed very well with the savings (except the last year due to global crisis), but if savings in KPST could not cover all the life of a citizen, is the state that should offer pensions for the latter citizens.

Third, the government should reform the war pensions. The war pensions, especially veteran's ones, represent a big mismanagement and a big failure in the whole system. Inclusion of fake veterans in lists and the fact that veterans' pensions have contributed to the population's passivation are clear signs that the reform should happen urgently. The list must be investigated and come with real war veterans. Then the law of veterans must be changed. The veterans should be allowed to work, because they may work informally and with the changes to the law they would be transformed from the informal employees to formal ones.

Fourth, the advantage of Kosovo is the youth and Kosovo should take benefits from them. While other nations are facing an aging problem, Kosovo should create strategies to keep the youth in the country. With the active population who work, the state would easier to achieve and maintain fiscal sustainability.

4. Conclusions

This study had in focus the fiscal sustainability and its linkage with the pensions programs. It presented the pension challenges from the perspective of WB6 and it compares with the most developed economies such as the USA, EU and Japan. A broader focus was given to Kosovo, a state in WB6, which represents a unique case in WB6 due to the demography and challenges regarding the pension. The aging seems not to be a big problem in Kosovo, because the number of youth represents the majority of the population. but a concern about Kosovo is the migration which can decrease the number of youth and increase the number of elderly people. In the aspect of pensions Kosovo has faced a lot of challenges caused by the war. The after war pension system caused a lot of inequality and discrimination, because all elderly people were treated in the same way without taking in consideration their work experience from the past. Another challenge for Kosovo presented in the study is the mismanagement of war pensions. The identification of war veterans has a lot of mistakes and fake veterans now receive regular pensions. The law of veterans must be changed and also Kosovo needs to take advantage of the youth in the country. Kosovo should create strategies to keep the youth in the country. With the active population who work, the state would achieve and maintain fiscal sustainability.

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