SP DISCUSSION PAPER NO. 0707

The Kosovo Pension Reform: Achievements and Lessons

John Gubbels
David Snelbecker
Lena Zezulin

April 2007

Social Protection
THE WORLD BANK

The Kosovo Pension Reform:
Achievements and Lessons

John Gubbels
David Snelbecker
Lena Zezulin *

April 2007

* John Gubbels was an independent pensions consultant at the time of the Kosovo pension reform. David Snelbecker is Senior Vice President of The Services Group (TSG). Lena Zezulin, a pensions lawyer, is a Senior Legal Consultant with TSG. All three authors played a significant role in designing and implementing the new pension system in Kosovo. John Gubbels served as the Acting Director of the KPST in its first year of operation.

Abstract

During 2001-2003, a fundamentally new pension system was designed and implemented in Kosovo. The system has three components, or "pillars." Pillar I is comprised of 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.

Pillar II 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 abroad, through major European asset managers. There are no legal requirements or restrictions on overseas or domestic investment, though high standards are set for the security of instruments. KPST participant assets surpassed Euro 100 million in early 2005 and reached Euro 200 million late in 2006. Collections are centralized to minimize administrative fees.

Pillar III of the system provides for supplemental, individual or employer-sponsored pension schemes. The Banking and Payments Authority of Kosovo (the BPK—Kosovo's equivalent of a central bank) licenses and regulates all third-pillar pension schemes. The BPK also regulates the KPST.

The reform has achieved a number of important policy outcomes. Pillar I helps avoid high payroll taxes since there is no wage-based "social contribution." 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. Pillar I achieves near universal coverage 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 Pillar I benefit level 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 Pillar I ensures poverty avoidance and Pillar II serves as the main vehicle for savings. Funds under Pillar II 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 system now is comprehensively implemented, having

wrestled with issues of collection, record keeping, IT systems, and information reconciliation processes.

Implementing the Kosovo reform was dependent upon a number of key factors: 1) recognition on the part of Kosovo's emerging political leaders of the need for pension reform; 2) policy makers within UNMIK who had a vision of an appropriate pension system for Kosovo; 3) a strategy for implementing the reform in light of existing institutional, economic, and financial constraints; and 4) significant technical expertise to implement the system in a challenging, post-conflict environment.

This paper tells the story of the Kosovo reform and draws policy and implementation lessons from the experience. The paper discusses policy issues and implementation experience in great detail, to serve as a resource for others interested in various aspects of the Kosovo reform. Readers who want to understand an overview of the reform and key lessons drawn from the experience may wish to turn immediately to: Section II.2, which presents an overview of the three pillars; Sections III.7 and IV.18, which present the specific challenges confronted in implementing Pillars I and II, respectively; and Section VI, which summarizes the lessons learned about policy and implementation issues from the Kosovo reform experience.

Acknowledgements

The authors wish to thank the following individuals for their support in the preparation of this paper: Yvonne Sin, Robert Palacios, and Alexi Sluchynsky, all of the World Bank, for their support and input; Estelle James and Steven Bates, Board Members of the Kosovo Pension Savings Trust, for their review and comments; Matthew Waterfield and Eimar Coleman for input on Pillar I; Arieta Koshutova, Fatbardha Bytyci, Nagip Krasniqi, Teresa Petrocco, and the staff of the Kosovo Pension Savings Trust for data on the KPST; Edgar Balbin for data on Pillar III; Magda Tomcyznska and Selim Thaqi for economic data. The work that the authors did on behalf of the Kosovo pension system was enabled by generous and sustained support from the United States Agency for International Development (USAID), which steadfastly backed the reform and catalyzed donor consensus around it.

Table of Contents

List of Acronyms

BPK	Banking and Payments Authority of Kosovo
CFA	Central Fiscal Authority
CPC	Central Processing Center
CPI	Consumer Price Index
DFID	UK Department for International Development
EET	Exempt, Exempt, Taxed (tax treatment for contributions, gains, benefits)
EU	European Union
GDP	Gross Domestic Product
ILO	International Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
ITN	Individual Tax Number
KEK	Korporata Energjetike e Kosoves (Kosovo Energy Corporation – the electricity utility)
KPST	Kosovo Pension Savings Trust
MEF	Ministry of Economy and Finance
MLSW	Ministry of Labor and Social Welfare
MPS	Ministry of Public Services
NATO	North Atlantic Treaty Organisation
OECD	Organisation for Economic Co-operation and Development
PAYG	Pay As You Go
PISG	Provisional Institutions of Self-Government
POE	Publicly Owned Enterprise
PTK	Post and Telecom of Kosovo
SOE	Socially Owned Enterprise
SOK	Statistical Office of Kosovo
SRSG	Special Representative of the Secretary General (of the United Nations)
TA	Tax Administration
UNMIK	United Nations Interim Administrative Mission in Kosovo
UNMIK ID	UNMIK Identification Number/Card
USAID	United States Agency for International Development
WB	World Bank

I Introduction and Background

The intent of this paper is to describe the reform of the Kosovo pension system, in order to document the policy choices and implementation experience, as well as to suggest lessons to be learned from the reform.

In some respects, the Kosovo experience was unique; in other respects, the issues faced are universal to any country embarking on a comprehensive pension reform. The particular governing structure of Kosovo, under a UN protectorate administration with a parallel Kosovar government, is unlike the governance of almost any sovereign country. Interruption of pension payments during the conflict in the late 1990s made it easier to consider abandoning the old pension system and starting anew. Continuing ethnic tensions left the issue of Belgrade's pension liabilities to be addressed during multi-party negotiations in later years. These factors are unique when compared with other countries that are undergoing pension reform. Nonetheless many aspects of the Kosovo reform are highly relevant for many countries, particularly small countries with poorly developed capital markets. Such aspects include the new, unfunded basic pension paid from general revenues, the centralized nature of the Kosovo Pension Savings Trust, and the initial practice of investing all funds outside of Kosovo.

The reform began in 2001, two years after the end of the Kosovo conflict, and with Kosovo under the administration of the United Nations Interim Administrative Mission in Kosovo (UNMIK). Impetus for pension reform came from the bottom up. Former pension recipients were actively demanding the re-establishment of some kind of pension system, with the sympathy of the broader Kosovar society. Based on this popular sentiment, Kosovar leaders urged that the pension issue be put at the top of the policy agenda, though they did not initially favor any one reform path over others. Donors responded with combined resources to address this need for the immediate design and implementation of a new pension system. The pension policy design was led by consultants funded by USAID, with involvement from representatives of UNMIK, the EU, the IMF, the World Bank, DFID and the ILO. It is important to understand that the motivation for a comprehensive pension reform to provide adequate pension income for Kosovo elderly came primarily from Kosovar society. The donors then stepped in, and provided significant leadership in encouraging selection of a pension reform model that has turned out to be effective and successful.

The initial assessment of pension needs was broad in its scope, not only looking at those elderly who were receiving pensions before the conflict in 1998. It also considered elderly who had not participated in the old Yugoslav pension system, working-age generations that had not been able to make contributions to any form of pension savings program, and overall social-sector priorities.

Policy discussions resulted in agreement to establish a three-pillar pension system, the cornerstone of which would be a mandatory, defined contribution pension fund for working Kosovars. Due to political factors and pressure from stakeholder groups, the pace of reform was swift. The pension regulation (Regulation 2001/35) was approved by UNMIK late in December 2001, providing the legislative base for Pillars II and III. A law, passed in the newly created Kosovo Assembly in Summer 2002, laid the legislative foundation for Pillar I. All three components of the system became operational during 2002.[1]

As of the writing of this paper, each of the three pillars of the pension system is administered primarily by local, Kosovo officials. Pillar I is administered by the Provisional Institutions of Self-Government (PISG), through the Ministry of Labor and Social Welfare (MLSW). Pillar II is administered by the Kosovo Pension Savings Trust (KPST), which is an independent body, staffed by Kosovar management and employees (the Governing Board has a combination of local and foreign membership). Pillar III institutions are licensed and regulated by the Banking and Payments Authority of Kosovo (BPK), a predominantly local, central regulatory and banking body.[2]

International support for the continued development of the pension system is ongoing. USAID continues to fund consultants tasked with strengthening the Pillar II and Pillar III institutions, while the EU, as part of the UNMIK administration, has assisted with Pillar I implementation (and provides limited support to Pillar II administration).

In general, the pension reform in Kosovo has been a success to date, though not without its challenges. This paper discusses policy issues and implementation experience in great detail, to serve as a resource for others interested in various aspects of the Kosovo reform. Readers who want to understand an overview of the reform and key lessons drawn from the experience might want to turn immediately to: Section II.2, which presents an overview of the three pillars; Sections III.7 and IV.18, which present the specific challenges confronted in implementing Pillars I and II, respectively; and Section VI, which presents in summary the lessons learned about policy and implementation issues from the Kosovo reform experience.

I.1 Political Context

Prior to the political turmoil of the 1990s, Kosovo was a province of Serbia, within the Federal Republic of Yugoslavia. The province has a mixed ethnic composition, with the vast majority of the population being of Albanian ethnicity.[3] Until 1989, Kosovo was considered an autonomous province of Serbia, and enjoyed considerable freedom to

---

[1] In May 2005, the SRSG signed an amendment to Pension Regulation 2001/35, by enacting Regulation 2005/20. The revisions embodied in the amendment reflect the changed operational and political realities since 2001. Most significantly, the amendment changes the manner by which Board Members are selected for the Kosovo Pension Savings Trust, the institution mandated with administering Pillar II of the pension system. Throughout this paper, the changed policies and procedures will be referred to as the 2005 regulatory amendment.

[2] While the BPK is staffed by Kosovar employees, the IMF appoints the Managing Director, and a small number of other management team members are funded by international donors.

[3] Post conflict estimates indicate that ethnic Albanians account for more than 90% of the territory's population, the remainder being Serb and other ethnic groups.

govern its affairs with independence from Belgrade. In 1989, the President of Yugoslavia, Slobodan Milosevic, withdrew Kosovo's autonomous status and brought the province under the direct authority of Belgrade. Thereafter ensued a period of considerable oppression of the Albanian ethnic population by the Milosevic regime, including forcing Albanians out of formal-sector jobs.

The change in the political landscape led to the development of resistance in Kosovo, including the birth of militant movements. In 1998, open conflict erupted between Serb and Albanian forces, as large numbers of Serb troops entered the province. The conflict resulted in a significant number of deaths of Kosovar Albanians and the forced removal of more than 400,000 people from their homes.[4] In 1999, after failed negotiations, NATO forces entered the conflict with an aerial bombing campaign that lasted 77 days and resulted in the full withdrawal of Serbian forces from Kosovo.

In June 1999, the United Nations Security Council passed Resolution 1244, which provided for the establishment of an international civilian administration in Kosovo. The United Nations Interim Administration Mission in Kosovo (UNMIK) was established to govern the territory under the direction of the Special Representative of the Secretary General (SRSG).[5]

Recognizing the importance of developing local governance, UNMIK established a Constitutional Framework. This document defines the power sharing arrangements between UNMIK and local governing authorities. It paved the way for the creation of the Provisional Institutions of Self-Government (PISG), and set parameters for the gradual transfer of powers to the PISG.

The first elections for the PISG were conducted in late 2001, leading to the establishment of a local governing structure in early 2002. The structure included the creation of government ministries, including the Ministry of Economy and Finance that has gradually taken over from UNMIK's Central Fiscal Authority. A second election was conducted in 2004. As the PISG has developed capacity, UNMIK has progressively transferred authorities to its local counterparts.

At this time, UNMIK continues to retain authority over some key areas of governance, including policy relating to financial institutions. With respect to pensions, administrative authority over Pillar I of the pension system has been transferred to the PISG, through the Ministry of Labor and Social Welfare. Final authority over Pillars II and III remain the responsibility of UNMIK, though the KPST and the BPK pensions regulatory unit are staffed and operated entirely by Kosovars (The KPST Governing Board is comprised of local and international members).

The political environment partially shaped the development of Kosovo's pension policy. Both the international community and the PISG played significant roles in policy

[4] For further information on the Kosovo conflict and NATO's role, see the following web site: www.nato.int/kosovo/history.html.
[5] For further information on UNMIK, see the following web site: www.unmikonline.org.

development and approval. The presence of UNMIK and other international organizations (e.g., USAID, World Bank, IMF) strengthened the position that a new pension system should be designed and implemented, rather than a recreation of the old PAYG system. These organizations supported the concept of a system that is consistent with international best practices. This support allowed for the creation of a Pillar I structure that is designed to be equitable and fiscally sustainable. It also paved the way for the design of the KPST as an independent body, with a Governing Board made up of qualified individuals, without regard to nationality. Most important, there was strong international support for the implementation of prudent rules for the investment of pension assets, resulting in the investment of assets outside of Kosovo, to date.

It is important to note that impetus for pension reform came from Kosovar society itself, not from the international community. The PISG has been supportive of the pension reform efforts and the broad directions for reform suggested by internationals, and its involvement has gone beyond the implementation of the regulations. The administration of the basic pension (Pillar I) is defined in Law 2001/1. This was the first law passed by the PISG in the newly created Kosovo Assembly. Similarly, the laws creating the disability pension and the social assistance system were introduced and passed in the Kosovo Assembly. These three programs fall under the authority of the MLSW, as some of the first responsibilities transferred from UNMIK to the PISG. In general, Kosovar leaders were not eager to re-implement the old pension system, as they associated it with the Milosevic period. A shift away from that system, which excluded many ethnic Albanians, to a more universal system, was appealing to them.

Given the PISG's support for the pension reform, it is difficult to determine the extent to which the reform would have been altered without the strong international presence. The voices calling for the recreation of the Yugoslav system may have been louder, and approval and implementation of a new system would certainly have been delayed by extended debate, had Kosovo not been under international governance. The direction of the pension reform may or may not have been roughly the same as that which took place.

Of greater significance will be the extent to which there may be future changes to the pension system as authority is transferred to the PISG. In particular, some of the more contentious issues, such as the political independence of the KPST Board and the investment of KPST assets outside of Kosovo, could witness increasing pressure for change. On the latter issue, pressure to stop the flow of pension assets out of Kosovo could result from two factors: 1) nationalist political pressures as authority is transferred; and, 2) reduction in capital inflows from international donors which have effectively offset the outflow of pension assets to date.

The prospect of future EU membership discussions may provide incentive to maintain international standards in the pension system as Kosovo's development moves forward. Of greatest significance will be the maintenance of financial prudence and sustainability.

I.2 Pension History

Before the 1998 conflict, Kosovo was covered by the Yugoslav pension system. This was a "pay-as-you-go" (PAYG) system in which current workers made contributions to the pension fund, and those contributions were used to pay benefits to current pensioners. Pension levels were determined by a benefit formula based on years of service and salary level. Until 1989, Kosovo had an autonomous pension fund that collected contributions and paid benefits. In 1989, these functions were centralized to Belgrade, and the regional Kosovo fund was disbanded. Many Kosovar workers were excluded from the system as of 1989 when they were removed from formal-sector labor positions. From the beginning of the conflict, Belgrade ceased paying pensions to most past contributors.[6] After the conflict ended, UNMIK began a social assistance program that included payments to certain categories of elderly on a needs-tested basis. These payments to elderly did not cover a large share of the older population, mostly did not go to those who made past contributions, and were seen as social assistance rather than pension benefits.

The following table gives information on pensioners who were already receiving pensions before the conflict:

Pensioners receiving pensions as of December 1998

Birth year	Old-age	Disability[7]	Survivor	Total
< 1902	2	5	10	17
1902-1930	11,669	7789	12,959	32,417
1931-1935	9786	5352	4708	19,846
1936-1940	8569	5110	3610	17,289
1941-1945	2235	3658	2304	8197
> 1945	784	4958	3999	9741
Total	33,045	26,872	27,590	87,507
Approx. total < 1937[8]	25,742	15,701	19,482	60,925
Adjusted total < 1937	21,202	12,755	14,954	48,910

Source: Kosovo Social Insurance Fund

The row labeled "Approximate Total < 1937" is the estimated number of former recipients who would be above 65 in 2002, and would be eligible for basic pensions. "Adjusted total < 1937" takes into consideration an estimate of the number of former recipients who likely would have died between December 1998 and 2002, using a mortality table from the region but not specific to Kosovo since reliable Kosovo tables were not available.

---

[6] Some ethnic Serbs continue to receive pension benefits from Belgrade, and there are indications that a small number of ethnic Albanians have succeeded in receiving pensions by collecting benefits through Serbia.

[7] This category includes several types of disability pensions, including Invalid (*Invalidor*), Caregiver (*Nd. Kujd.*), Physical injury (*D. Trupor*), Category II (*Shkalla II*), Category III (*Shkalla III*).

[8] This is estimated as all born through 1935 and half born between 1936 and 1940.

Demographic data suggested that the number of individuals over 65 was approximately twice the number over 65 and receiving pensions. That is, the coverage rate of the old pension system was quite low, reaching roughly half of the elderly population.

Consideration had to be given to those who were receiving pensions before the conflict and those who had contributed but not yet reached pension age. The main source of data for both of these categories was a set of databases maintained by the people who had led the Kosovo Pension and Invalidity Fund. At the time of the reform, these people worked in the Pension Section of the Kosovo Social Insurance Fund, within the UNMIK Department of Health and Social Welfare. They had data on individuals who were receiving pensions as of December 1998 and on individuals who were still working at that time, and had made contributions to the system. In general, the data available on those who already were receiving pensions was of better quality than the data on those who were still contributing to the system before the conflict.

For each former pensioner, a record existed in a computer database (programmed in Unix on a PC) that included birthdate, address (perhaps not current), and other personal information. Information was also available regarding the pension levels and expenditures for various programs. Much of the information on birthdates had been added by the employees of the central Social Insurance Fund, who contacted regional offices in the initial years after the conflict. This suggested that the quality of the data for former pensioners was relatively high since they seemed able to reconstruct a comprehensive database using existing records.

The data on former contributors who had not reached pension age was less complete. The way contributions were recorded in the old system was as follows: Employers would send to the Pension Fund an M1 Form notifying when individuals had started employment, and an M2 Form notifying when individuals ceased employment. (The M1 and M2 Forms were introduced around 1968, replacing PS Forms that had been used in earlier years. An M3 Form was used to correct mistakes on M1 and M2 Forms.) Employers would notify the Pension Fund about salary level (from which contributions were made) on a periodic basis using M4 Forms. When a person reached retirement age, the "Professional Service" of the Pension Fund would evaluate the salary history, often contacting former employers to verify salary levels since employers did not consistently provide M4 information to the Pension Fund. This introduced considerable discretion into the process of determining the level of the pension.

During the conflict, a NATO cruise missile hit the post and telecommunication building next to the Social Insurance Fund. A fire destroyed most M1 and M2 Forms, but M4 and PS Forms, stored on a lower floor, survived. As a result, there still existed good information on birthdates of older contributors to the system (PS Forms) but not of younger contributors to the system (M1 and M2 Forms). There was good record of past contributions to the system (M4 Forms), to the extent that employers had sent this information to the Pension Fund, but no information on start and stop dates of employment (M1 and M2 Forms).

In summary, at the moment reforms were designed, there existed some data on past recipients, and less on past contributors who had not reached pension age, leading some to advocate re-creating the old Yugoslav pension system based on a belief that sufficient information existed to re-establish contribution histories. Instead, a dramatically different approach was followed.

I.3 Demographics

Compared to other countries in the region, the population of Kosovo is particularly young. When the reform was designed, the population was thought to be roughly 2.2 million people (but in fact was probably somewhat smaller). Of this population, only approximately 130,000 (or less than 6%) were 65 or older. (Throughout the reform process an assumption was used of total population size of 2.2 million. Others believed the population was as low as 1.9 million, meaning that the absolute population numbers could all be up to 9% lower than is supposed in this analysis.) There were approximately 1.4 million people of working age (16-64), meaning that the "demographic dependency ratio" (the ratio of elderly to working age) was about 0.1. That is, there are roughly ten people of working age for every elderly person. This was perhaps the most advantageous ratio in all Europe, where often such ratios are below three working-age people per elderly person.

Demographic information is given in the following tables:

Age Structure of the Population, 1999 and 2003						
	1999			**2003**		
Age Group	**% Male**	**% Female**	**Total %**	**% Male**	**% Female**	**Total %**
0-15	32.8	29.5	31.2	33.5	30.9	32.2
15-59	58.7	61.4	60.2	57.9	59.6	58.7
60 +	8.5	9.1	8.8	8.6	9.5	9.1
Total	100	100	100.2	100	100	100

Source: Kosovo Demographic and Health Survey 2003. Preliminary results. Draft chapters, April 2004.

Rate of Natural Increase, 2003		
Component of Growth	**Basic Calculation**	**Rate**
Crude Birth Rate (CBR)	Per thousand population	23
Crude Death Rate (CDR)	Per thousand population	7
Rate of Natural Increase	Per hundred population	1.6

Source: Kosovo Demographic and Health Survey 2003. Preliminary results. Draft chapters, April 2004.

Although the population was young, it was clearly starting to age. This can best be seen in falling fertility rates:

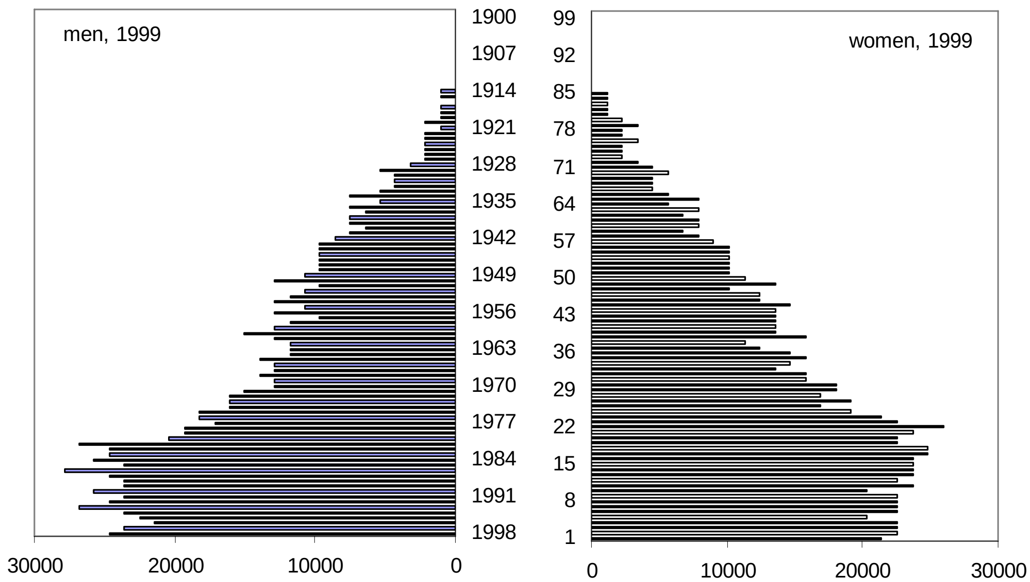
Estimated Fertility Rates (average number of children per woman in each birth year cohort)									
1940-1942	1943-1945	1946-1948	1949-1951	1952-1954	1955-1957	1958-1960	1961-1963	1964-1966	1967-1969
4.38	4.43	4.18	3.94	3.74	3.71	3.42	3.13	2.97	2.65

Source: "Demographic, social, economic situation and reproductive health in Kosovo following the 1999 conflict: Results of a household survey, November 1999-February 2000," International Organization of Migration, Table 11, p39.

Women were having fewer children. This trend had taken place for many years and was not simply a result of the 1998 conflict. So the advantageous ratio of elderly to working-age was becoming less and less favorable. Note that this drop in fertility rates was quite dramatic. On average younger women today are expected to have almost two fewer children than women of their mothers' generation.

Based on the IOM demographic survey and an assumed total population of 2.2 million people, the 1999 total population distribution was estimated, as shown in the following chart.

Estimated 1999 population



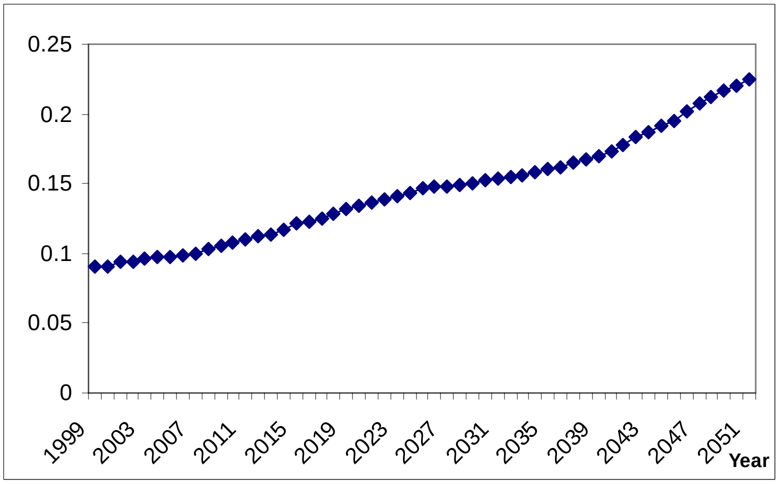
The left-hand side shows men, the right-hand side women. Ages and birth years are given in the middle. From this picture it is clear that the Kosovar population is young, though from the fertility rates given above, it is also clear that the population is beginning to age rapidly. Notice how the profile of the population looks like a triangle, with each set of generations larger than the set older than it, except at the base, where there seem to be almost as many children as there are young adults. This suggests an aging of the population and changes in the proportion of older to younger citizens.

The following long-range projection shows how the demographic dependency ratio was expected to worsen over time.[9] (Note that this is only a crude approximation, and that it is probably quite conservative since it is not assumed that fertility rates would continue to fall.)[10]

9 This shows an increase in the burden the elderly would place on the working-age if the young are required to provide PAYG pensions to the old.

10 When these demographic projections were made, reliable information was available for some demographic factors in Kosovo but not for others. These projections were made assuming steady fertility rates (based on a survey of Kosovo households to determine a baseline), and mortality rates that start at the levels in Ukraine at that time and that evolve over 20 years to the levels in Holland.

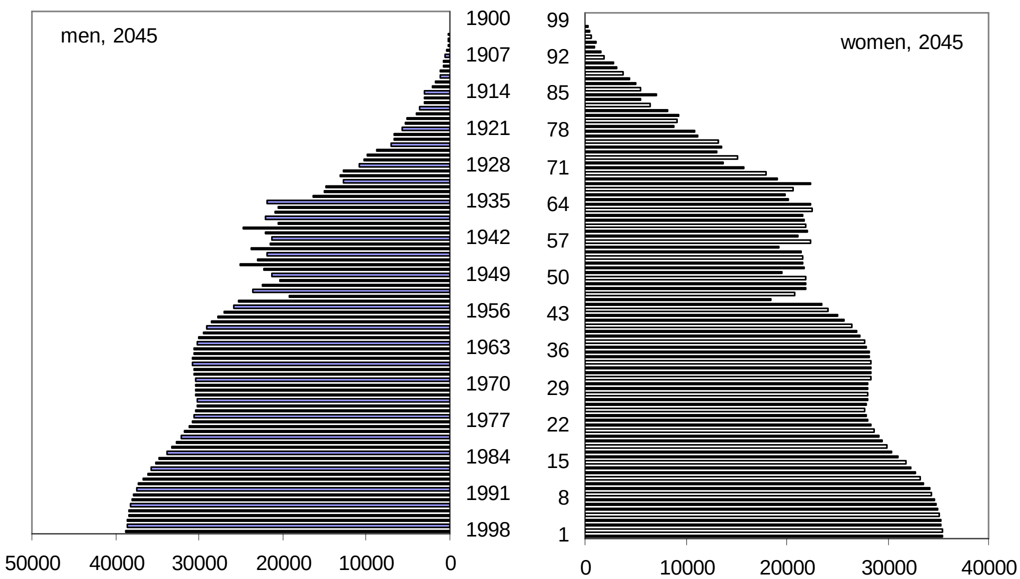
Projected demographic dependency ratio:
Ratio of elderly (>65) to working-age (16-65)



The following table, constructed in 2001, gives estimates and projections of the demographics in the near term:

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
>= 65	122,296	125,147	131,548	135,178	140,086	144,429	146,436	150,053	155,345	162,159	168,611	174,732
annual inc.		2%	5%	3%	4%	3%	1%	2%	4%	4%	4%	4%
inc. from base 2001				3%	6%	10%	11%	14%	18%	23%	28%	33%
as share of total pop.	5.5%	5.6%	5.8%	5.8%	6.0%	6.0%	6.0%	6.1%	6.2%	6.4%	6.5%	6.6%

A projection of the population in 2045 is given in the following chart. Note the contrast in age structure compared with the similar picture above.



This means there would be fewer working-age people to support more elderly people.

I.4 Economic Conditions

Kosovo's economy has been recovering from the conflict, albeit at a disappointingly slow pace. After a few years of high growth immediately following the conflict, growth has been small or even negative in recent years. The economy has been constrained by a number of factors including:

- occasional violence;
- lack of resolution of political status, which causes uncertainty for investors and prevents Kosovo from fully participating in international trade regimes;
- electricity disruptions; and,
- labor market problems due to international donor demand driving wages. This makes Kosovar production less competitive on regional markets.

Kosovo adopted the Deutschmark, and then the Euro, ensuring full currency convertibility and low inflation, even deflation in several years. Unemployment has been high, at close to 30% according to sound estimates done by the IMF and Ministry of Economy and Finance.[11] This level is on par with those found in a few neighboring countries, such as Macedonia.

The most striking feature of Kosovo's balance-of-payments is the large inflow of money, mostly from donors but also in the form of remittances. These inflows are an important factor for the pension reform since they mean that outflows of pension investments, during a lengthy transition stage,[12] can have a positive economic impact. The problem is that large donor and remittance inflows can push up real wages (in a way similar to currency appreciation if Kosovo were not using the Deutschmark and then the Euro), which makes labor and, therefore, manufactured goods uncompetitive internationally. This is a problem akin to what economists call "Dutch disease." Many small, resource-rich or donor-assisted countries would have balance-of-payments somewhat similar to Kosovo. In such cases, the outflow of pension assets may mitigate these problems. However, other countries, with balance-of-payments characterized mostly by large current-account deficits, might have a hard time handling large outflows of pension assets. So far Kosovo has no explicit debt, though it is possible that a significant burden from the Yugoslav era could be apportioned to Kosovo during final-status negotiations.

[11] Some questionable assessments, by other sources, place the level higher. However, these assessments are not based on sound international statistical standards.

[12] Before an equilibrium is reached when pension investments flow back into the country to pay benefits.

Economic Indicators

	2001	2002	2003	2004	2005	2006	Source
GDP (Billion Euro)	2.439	2.447	2.426	2.516	2.433	2.428	Aide Memoire – IMF May 05
Economic Growth (%)	16.6	-2.9	-1.1	3.7	-0.5	2.3	Aide Memoire – IMF May 05
Unemployment Rate – SOK Survey *	-	57.1	-	-	-	-	
Unemployment Rate - MLSW Publication **	-	-	42.9	42.3	-	-	
Unemployment Rate – IMF Estimation	-	-	30.1	29.5	28.9	28.4	Kosovo – Gearing Policies Toward Growth and Development
Inflation (CPI)	11.7	3.6	1.1	1.3	-	-	SOK regular publication of CPI

* SOK – Statistical Office of Kosovo

** MLSW – Ministry of Labor and Social Welfare

I.5 Policy Environment

Although a new pension system would not seem to be the highest priority for a post-conflict society, in fact it had become a politically explosive issue. Given the cradle-to-grave culture of social programs in Yugoslavia (despite the reality of coverage to only part of the population), Kosovars identified creating a new pension system as a key first step in returning to normalcy and civility. Recipients under the old pension system protested repeatedly in front of UNMIK headquarters, even chaining themselves to the fence outside the SRSG's office. Most of the proposals on the table at the outset were merely to re-create the old Yugoslav system. Most experts thought that this path would be disastrous for Kosovo. The old system gave very high pensions, but only to part of the elderly population (as well as to many non-elderly), all at high cost, including onerous payroll taxes that contributed to unemployment and the shadow economy. Re-introducing the old pension system at a time when the population was aging would have exacerbated fiscal problems for the future Kosovo economy.

Kosovo policymakers and international governors and advisors confronted a stark choice. They could do nothing and slide from political pressure toward re-creating the old Yugoslav pension system, locking society into the old pension model for generations. Alternatively, they could act decisively to take advantage of a political window of opportunity, and support from UNMIK, to introduce an entirely new system. They chose the latter path.

It was agreed that a new, modern pension system should be developed, free of the burden of past pension liabilities. This freedom to start with a blank slate facilitated a quick reform (without protracted debate over transition issues), and it allowed fiscal room for Pillar I that would be expanded to cover the whole elderly population.

II Pension Policy Development

II.1 Broad Principles and Specific Objectives of the Reform

In developing a pension strategy for Kosovo, policymakers considered the importance of the following four broad pension principles, which are relevant for any pension system:

- *Lifetime consumption smoothing.* A pension system should allow the working-age population to set aside income for retirement years to facilitate consumption smoothing. That is, the system should help ensure that people can consume roughly as much in old age as they did when of working age, even though they no longer continue to receive wage income. Consumption smoothing can be achieved either through true savings in financial markets or also by giving contributions to the state in exchange for a promise to pay a future pension benefit.
- *Insurance function.* A pension system should allow participants to insure against certain risks: uncertainty of longevity (that is, we do not know how long we will live), and also the possibilities of becoming disabled during work career, or of dying and leaving survivors in need of support. Risks of the pension system itself also should be well managed—market and institutional risks in funded systems, and demographic, fiscal and political risks in unfunded systems.
- *Redistribution and provision of a social safety net.* A pension system is one of society's primary means of redistributing wealth across and within generations, for instance, from richer to poorer, and of ensuring that poor elderly receive at least a minimum income.
- *Compatibility with economic growth.* While not its primary function, a pension system must be compatible with economic growth, labor market efficiency, and development of capital markets.

The following specific objectives guided the design of the new Kosovo pension system:

Avoid recreating the old Yugoslav socialist pension system. 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, early retirement ages, special categories of earlier retirement, a complicated benefit formula, and increasing financial unsustainability. Only part of the population was covered. 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 the Yugoslav system. Therefore, it was decided that a clean start should be made with a new, modern pension system. While it was important to address the issue of previous contributions, it was agreed that UNMIK should not formally assume liabilities of the Belgrade pension fund. Claims on Belgrade should be addressed in discussions with the Belgrade authorities.

Create a pension system that covers the whole population. European countries present a wide array of possible pension schemes, with various mixes of funded PAYG, mandatory and voluntary, private and public components. The one feature common to all European countries is that the systems cover almost the entire population. In contrast, in Kosovo, the Yugoslav pension system covered only about half of the elderly in 1998.

Address the needs of all population groups: The relevant populations groups could be categorized as follows: 1) The elderly who contributed to the past system (up to 25,000 old-age pensioners, or less than 1.5% of the population, who felt they are entitled to benefits based on these past contributions; plus approximately 25,000 over 65 who were receiving survivor and disability pensions); 2) The elderly who did not contribute to (or were excluded from) the past system (roughly 90,000, or up to five percent of the population, who may be equally in need of a pension as those who contributed); and 3) The current working-age (up to 1.4 million individuals 16-65, who were not making contributions to any pension system and were not earning entitlements to any future pensions).

Seek a comprehensive solution. The best pension policy would be one that addresses not only immediate political pressures and budget constraints, but one that also leads along a path to creating a pension system that is sustainable in the long-term, given changing demographics, and is consistent with the development of a market economy.

Take advantage of the political window of opportunity. This was a period when political pressure to address pension issues was high and the governing authorities had the capacity to enact a well-thought-out proposal that recognizes budget constraints and addresses concerns regarding sustainability.

Address ethnic concerns. All pensioners and workers should be allowed to participate in the new system on equal terms regardless of ethnicity. An issue arose because some people continued to receive pensions from Belgrade while most did not. A political decision was taken to give everyone in Kosovo pensions even if they also receive pensions from Belgrade or have other sources of income.

Promote economic development. To the extent feasible, the pension system should facilitate savings and investment of the population, rather than relying on mechanisms that are similar to issuance of government debt. Furthermore, the pension system should promote development of the labor market, suggesting that contribution rates be set at reasonable levels and that pension programs offer participants acceptable returns on their contributions so that there are incentives to participate.

II.2 Overview of the Three Pillars

In December 2001, following extensive policy discussions with all political parties, UNMIK approved the implementation of a three-pillar pension system, as defined in

UNMIK Regulation 2001/35.[13] Pillar I is comprised of a basic pension and a disability pension. The basic pension pays a flat benefit to all habitual residents of Kosovo who are 65 years of age and older. The decision to opt for a new, universal, flat benefit was based on: 1) a desire to avoid high contribution rates and to promote long-term fiscal sustainability; 2) the low rate of coverage provided by the old system; 3) the poor state of contribution records for the old system; and 4) political challenges in determining how to equitably treat those who were forced out of their jobs and denied the opportunity to participate in the pension program in the decade following the political changes of 1989. The new basic pension is designed so that it does not discriminate based on work history, sex, or ethnicity. The benefit is funded from general government revenues, on a pay-as-you-go basis, with universal eligibility upon reaching age 65 regardless of other income sources. The amount of the monthly benefit is determined annually during the budgeting process, based on the methodology set out in Law 2002/1, and is reflective of the cost of a minimum consumption food basket, initially defined by the World Bank. The disability pension is similar in all respects except for eligibility, which is determined based on medically-confirmed, permanent disability. The implementations of the basic pension and the disability pension are governed by separate laws that were passed in the Kosovo Assembly. These laws were enacted by the PISG rather than UNMIK due to the fact that authority over Pillar I of the pension system was "transferred" from UNMIK to the PISG, through the Ministry of Labor and Social Welfare, while jurisdiction over financial institutions such as the KPST remained "reserved" to UNMIK.

Pillar II 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 to the pension trust. This worker contribution is matched by an additional 5% payment from the employer.[14] Both workers and employers are eligible to voluntarily contribute an additional 10% of gross salary. Thus, the maximum total contribution (mandatory and voluntary) for each individual per month is 30% of gross salary. Contributions and records are managed by the Kosovo Pension Savings Trust, an independent body established solely for the purpose of administering the savings pension system. The intent of the program is that, at the time of retirement (or permanent disability), an individual's pension savings are used to purchase a pension annuity.

Pillar III of the system provides for supplemental, individual or employer-sponsored pension schemes. The pension regulation mandates the Banking and Payments Authority of Kosovo (BPK), Kosovo's financial regulatory body, to license and regulate all Pillar III pension schemes.

The following table summarizes the components of the pension system:

[13] To view UNMIK Regulation 2001/35, see www.kpst.org/English/Dokumentet/.

[14] Self-employed individuals are considered both employer and employee, thus requiring a 10% contribution.

	Pillar I Basic Pension	**Pillar II** Individual Savings Pension	**Pillar III** Voluntary Individual or Employer Pension
Eligibility	All Citizens	Contributors	Contributors
Contribution rate	-	5% employee; 5% employer	Varies
Funding Method	PAYG; General Revenue	Funded; Payroll Contributions	Funded by Employer or Individual Contributions
Participation	Universal	Mandatory	Voluntary
Benefit	Monetary equivalent of a minimum consumption food basket	Defined contribution	Defined contribution or defined benefit
Coverage	All habitual residents, either 65 years of age and over or 100% disabled	Phased implementation; All working habitual residents	Initially very limited
Provider	Kosovo Pension Administration	Kosovo Pension Savings Trust	Employers, Pension Funds, Insurance Companies, Banks
Regulatory or Oversight Bodies	Ministry of Labor and Social Welfare; Ministry of Economy and Finance	Banking and Payments Authority of Kosovo (BPK)	Banking and Payments Authority of Kosovo (BPK)
Investments	None	Professional Asset Managers	Licensed Asset Managers and Insurance Companies
Collection Agent	None	Tax Administration	Employers, Pension Funds, Insurance Companies, Banks

Jurisdiction over the new pension system was shared by UNMIK and the PISG. In broad terms, jurisdiction over Pillar I programs was "transferred" to the PISG, while jurisdiction over pillars II and III remained "reserved" to UNMIK. This is consistent with other political decisions whereby social programs were "transferred" and responsibility for financial institutions remained "reserved." For this reason, the policymaking process for the several pillars differed. The Pensions Regulation establishing the KPST was signed by the SRSG after a consultative process with the PISG, but without formal consideration in the Kosovo Assembly. In contrast, the laws on the basic pension and on the disability pension were debated and adopted by the Assembly.

II.3 Expected Replacement Rates

Calculations of expected replacement rates from the mandatory components of the Kosovo pension system are highly sensitive to key assumptions, particularly regarding: real returns on pension assets (net of administrative fees); wage growth; "density" of contributions (how frequently during one's life one contributes); changes in the basic pension amount; and life expectancy at retirement.

The following table projects replacement rates resulting from KPST pension payments. Given the absence of mortality data for Kosovo, annuity factors are derived using the World Bank's mortality table for Albania's general population. Projections were derived for a male who retires at 65 years of age in 2040. In the case of the joint annuity, 100% spousal payment continues following death of the primary annuitant. The spouse is assumed to be three years younger than the male primary. Annuities are discounted at net real ROI minus 1%. Real wage growth is assumed to be 2%.[15]

KPST Replacement Rates[16]

Real Wage Growth and Real Investment Return Assumptions	Years of Work	Single Male	Single Female	Joint/ Spousal (100%)
2% Wage Growth; 2% Net ROI	30	19.7%	16.8%	13.2%
	40	26.3%	22.4%	17.7%
2% Wage Growth; 4% Net ROI	30	31.8%	27.7%	22.6%
	40	47.3%	41.2%	33.6%
2% Wage Growth; 6% Net ROI	30	51.4%	45.6%	38.4%
	40	86.7%	76.9%	64.7%

Incorporating the impact of the basic pension on RR is complicated by the fact that the basic pension pays a flat benefit regardless of previous wage. The following table presents replacement rates, at age 65, resulting from basic pension payments, for individuals earning 500 Euro and 1000 Euro per month in Year One. The calculations assume 2% real wage growth and that the basic pension benefit amount is held constant, in real terms, for 10 years and then is allowed to grow at the same rate as wage growth.[17]

[15] For simplicity, a constant wage growth estimate is used for this simulation. Currently there is 0% wage growth in Kosovo, and negative wage growth may be experienced in the short term, as donor support is reduced. However, for the long term, the simulation is based on the assumption of average 2% wage growth.

[16] "Replacement rate" is defined as pension divided by final wage.

[17] This would represent a policy change in Year 11. Currently the basic pension is price-indexed so that it will not rise in real terms. However, this may be unrealistic in the long term, as basic pension benefits would erode over time, assuming real wage growth and no policy change.

Basic Pension Replacement Rates

Assumptions	Years of Work	Final Monthly Salary (Euro)	Monthly Basic Pension (Euro)	Replacement Rate
Earning 500 Euro/ month in Year One	30	888	59	6.6%
	40	1082	73	6.6%
Earning 1000 Euro/ month in Year One	30	1776	59	3.3%
	40	2165	73	3.3%

Combining the above data and assumptions, the following table presents total RR for a future retiree who holds a joint/spousal annuity and begins with income of 500 Euro per month.

Total Replacement Rates

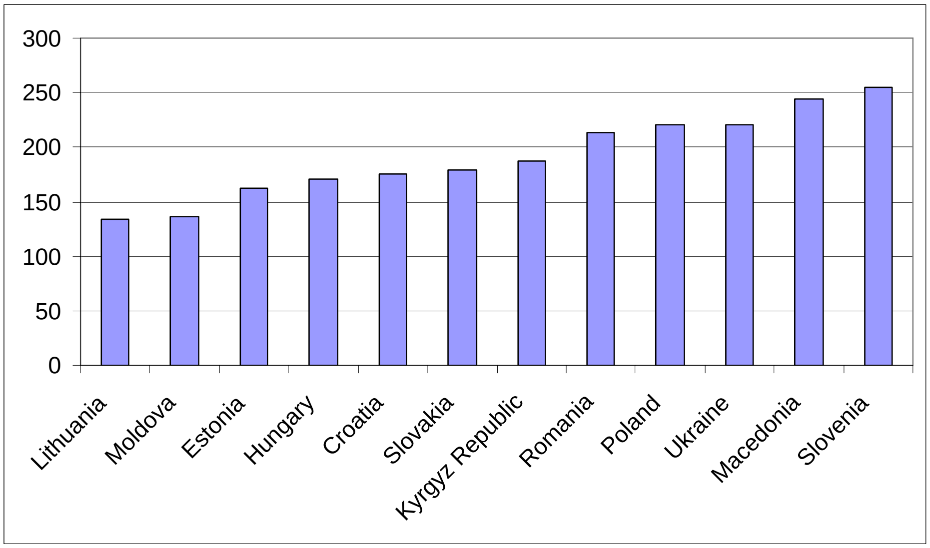
Real Wage Growth and Real Investment Return Assumptions	Years of Work	KPST RR (Joint/Spousal 100%)	Basic Pension RR	Total RR
2% Wage Growth; 2% Net ROI	30	13.2%	6.6%	19.8%
	40	17.7%	6.6%	24.3%
2% Wage Growth; 4% Net ROI	30	22.6%	6.6%	29.2%
	40	33.6%	6.6%	40.2%
2% Wage Growth; 6% Net ROI	30	38.4%	6.6%	45.0%
	40	64.7%	6.6%	71.3%

In this case, total replacement rate estimates range from approximately 20% to 70%. Note that this assumes consistency of projection factors. However, if the KPST annuity is price indexed and the basic pension becomes wage indexed, the proportion of total RR accounted for by the basic pension benefit will grow.

II.4 Claims Against the Previous Pension Scheme

A significant factor in pension reform worldwide is the degree to which pension liability is carried forward from the old system to the new system. The financial impact can be considerable, as shown in the following table.

Outstanding Implicit Pension Liability
(Percentage of GDP)



Source: World Bank. In these calculations, a 5% discount rate was used.

In the case of Kosovo, no liability from the previous pension system was recognized under the new system. It was decided that the extent to which Belgrade should and can be convinced to honor entitlements earned by former workers is a separate issue from setting up a new pension system in Kosovo. This political question was separated from the reform process and was left until a future time, when Kosovars might participate directly in discussions with authorities in Belgrade. UNMIK did not formally assume the pension liabilities of Belgrade. To do so would have been simply beyond available fiscal resources. This unique scenario created the fiscal room to introduce a universal, old age pension without needing to issue debt or seek other large sources of funds to cover transition costs.

The purpose of this strategy was to allow pension reform to move forward without becoming entangled in a morass of issues related to the old system. The adoption of a new pension system, however, did not in any way diminish or alter any liabilities Belgrade might have. The Ombudsperson of Kosovo has begun to pursue the issue of Belgrade's liabilities. To date, only initial discussions have taken place. High level negotiations on the status of Kosovo have begun, but they are focusing on the central issues of minority rights, decentralized governance for minorities, and geographical boundaries. It would be optimistic to assume that pension obligations will be considered a priority at any point in the near future. Indeed, the issue of pension liabilities may never be resolved.

III Pillar I

III.1 Overview

The basic pension has the following characteristics:

- Paid to all habitual residents 65 years of age and over; not linked to previous contributions.
- Set at the level necessary to buy a minimum consumption monthly food basket, as determined objectively by a price survey conducted annually. The logic behind this pension is to ensure that all elderly receive sufficient income so they do not fall below the minimum poverty level, even if they did not contribute to the system previously. It recognizes that most elderly in Kosovo live in extended families that partially support them. This pension should give elderly enough income to cover their marginal cost to their families.
- During the first several years, the pension level may need to be set even lower than the food basket cost if available resources are too limited.
- Is funded from general revenues.
- Is administered by the Kosovo Pension Administration, under the supervision of the Ministry of Labor and Social Welfare.

The basic pension was introduced in 2002, following the definition of implementation rules in a law passed by the Kosovo Assembly.[18] A disability pension was introduced, following adoption of a law on disability in the Assembly. The disability pension pays the same benefit level as the basic pension, and was introduced in July 2004, with back payments to January 2004. The disability pension also broke with the past, seeking to establish far tighter rules for granting pensions, based only on “total” and “permanent” disability, as confirmed by MLSW Doctors Commissions. Recipients are not allowed to claim both a disability and a basic pension.

The annual process for defining the monthly benefit level for the basic pension was set in a law passed by the Kosovo Assembly in July 2002. According to the process, the Ministry of Economy and Finance is responsible for conducting a survey of food costs and recommending to the government a benefit level reflecting the cost of a food basket. The government makes a final determination based upon the recommendation and budgetary constraints. In setting the 2005 benefit level, the MEF survey resulted in a recommendation for a benefit level of 41 Euro per month. Based on fiscal limitations, the government chose to maintain the benefit level at the 2004 level of 40 Euro per month. The following table shows benefit levels from 2002-2006. The disability pension pays the same benefit as the basic pension.

[18] Palacios and Sluchynsky (2006) show that the Kosovar ‘social pension’ is one of the most extensive (based on their index) when compared to other low and middle income countries.

Basic Pension Benefits

	2002	2003	2004	2005	2006
Monthly Benefit (Euro)	28	35	40	40	40
Monthly Benefit Annualized (Euro)	336	420	480	480	480
GDP Per Capita (Euro)[19]	1288	1277	1324	1280	N/A
Benefit as % or Per Capita Income	26.1%	32.9%	36.3%	37.5%	N/A

The purpose of the methodology for setting the basic pension benefit level was to anchor the pension to something objective in the economy, rather than setting pension levels merely through political decision-making. The cost of the food basket would remain roughly fixed, in real terms, helping to ensure long-term fiscal sustainability (assuming long-term growth in GDP per capita, even with some population increase, pension expenditures as a share of GDP would be expected to remain stable or even decrease with time). In the longer run, if the food-basket level were maintained, pension expenditures actually could be expected to fall considerably as a share of GDP, meaning that eventually a higher anchor could be chosen. The food basket was intended to serve as the target for the early years of the new system, but potentially could be changed in the more distant future.

This level also was chosen because it seemed fiscally sustainable in the near term while also alleviating old-age poverty. World Bank household surveying at the time indicated that many of the poor were only slightly below the poverty line, suggesting that even small amounts of money could make an important difference in bringing families over the poverty line.

The disability and old-age pensions work together seamlessly. Disability pensions cease at age 65 when old-age pension eligibility is reached.

The pension system also is designed to be integrated with Kosovo's needs-based social assistance program. The social assistance program provides monetary support to families in need of assistance, based on a formula that takes into consideration family income and size of family, excluding those over 65, recognizing that those over 65 already receive at least minimal support from the basic pension. The amounts granted under social assistance are synchronized with the pension system.

III.2 Administration by Ministry of Labor and Social Welfare

The basic pension was set up and is administered by the newly created Pensions Administration in the MLSW. Considerable effort was devoted to ensuring that this new administration represented a clean break from the past. It was not called a "fund", to avoid the perception of continuity from the previous social insurance fund.

[19] No reliable estimates of income per capita exist. Thus we have substituted GDP per capita.

One of the innovations in administration was to deliver pensions to recipients' bank accounts. Many at the time believed this would be impossible, given the fragile state of the financial services sector. Instead they advocated delivery through the postal service, as in the old system, which would have been administratively quite costly, less secure, and less transparent. The eventual system set up through the banking system has worked efficiently and with few problems. It effectively reduces costs for pensioners, in that recipients are not forced to travel to specific locations for collection of their benefits. Further, they do not have to queue to collect their pensions. Rather, they can collect their payments through automatic teller machines. The system also provides for joint accounts, allowing family members to collect pension payments on behalf of the retiree.

The system was designed to be user-friendly for new benefit applicants. The benefit application form asks the applicant to either indicate a bank and bank account number to which transfers should be directed, or to indicate a preferred bank and branch location. In the latter case, the Pension Administration opens the bank account on behalf of the pensioner. The secondary benefit of this approach was support for the expansion of the banking sector. During 2002, the number of commercial bank branches throughout Kosovo tripled.[20]

Another unique feature of the basic pension distribution was the creation of mobile banking units for the servicing of areas that were without normal banking coverage. The mobile units visited these areas on a regular schedule, providing services such as pension benefit collection, until the banking sector developed to sufficiently cover the Kosovo market through branch operations. The mobile banking units could serve as a model for other parts of the World where the distribution of pension benefits to remote areas represents a significant challenge.

The cost of distributing pensions through the banking system is born by the government. Banks are compensated at a rate of 5 Euro per year for each pensioner account. The fees were paid originally by the Pension Administration. The budget is now managed directly by the Ministry of Economy and Finance's Treasury Department.

[20] Monthly Macroeconomic Monitor, Kosovo. Ministry of Economy and Finance. May 2003.

III.3 Program Costs

	Basic Pension Payments		Disability Pension Payments		Total Payments (million Euros)	GDP (million Euros)[21]	Pension Cost as Share of GDP (%)
	No. of Recipients	Total Payment (million Euro)	No. of Recipients	Total Payment (million Euro)			
2002	45,495	17.9	N/A	N/A	17.9	2,246	0.80
2003	102,278	44.4	N/A	N/A	44.4	2,249	1.97
2004	112,926	54.9	15,077	7.248	62.148	2,282	2.72
2005	124,319	59.3	21,251	15.480	74.793	2,209	3.39

III.4 Medium Term Cost Projections

In 2005, the Government of Kosovo released its medium term budget framework for the years 2006 - 2008. The document reveals that social transfers are projected to increase at a rate of 3% annually in the medium term, reflecting demographic changes. The basic pension accounts for 53% of social related transfers, and this proportion is expected to increase to 56% by the end of 2008. Medium term projections assume that the basic pension benefit level will remain at 40 Euro per month through to the end of 2008. Projections for the basic and disability pensions follow.

Basic and Disability Pension Projections from Medium Term Budget Framework

	2005 Budget Regulation	2006 Projection	2007 Projection	2008 Projection
Basic Pension				
Cost (million Euro)	60.7	62.6	66.5	70.8
# of recipients (end of year)	125,832	132,718	141,886	151,109
Growth %		5	7	7
Monthly Benefit Level	40	40	40	40
Disability Pension				
Cost (million Euro)	12.6	14.4	14.4	14.4
# of recipients (end of year)	26,250	30,000	30,000	30,000
Growth %		14	0	0
Monthly Benefit Level	40	40	40	40

Source: Kosovo Medium Term Budget Framework, Budget Strategy 2006-2008

III.5 Program Coverage

Coverage has been nearly universal. The numbers of recipients of pensions have consistently been almost the same as estimates of the population over 65. (No census has

[21] From the IMF's Main Indicators for Kosovo, as provided by the Macro-economic Unit of the MEF.

been undertaken recently; thus, no precise data are available.) This is a dramatic increase in coverage from the old system, which reached just half the elderly population. Year-end 2005 data from the MLSW indicate that 124,319 pensioners were receiving the basic pension.

The proportion of the basic pension coverage accounted for by the minority population is very high. Whereas, minorities make up approximately 8% of the Kosovo population,[22] 19.7% of basic pension payments go to minority recipients.[23] This suggests that the minority population is considerably older than the general Kosovo population, and that the rate of participation of the minority community is very high.

Similarly, participation among women is high. 53% of basic pension payments are made to women.

Disability pension entitlement has been tightened significantly to minimize the level of abuse seen under the old pension system. All applicants for a disability pension must prove permanent, 100% disability, as certified by an MLSW Doctors Commission. Doctors Commissions have been established in the capital of Pristina, and in regional centers. This requirement is applied both to new applicants and recipients under the old system. The following table presents disability pension coverage and cost data to May 2005.

Disability Pension

2004			**2005[24]**		
Period	Number of Recipients	Cost (Euro)	Period	Number of Recipients	Cost (Euro)
July	57	15,960	January	15,962	1,135,040
August	1000	303,280	February	16,455	1,007,720
September	2463	565,560	March	17,664	1,427,480
October	6003	1,512,480	April	18,276	1,119,480
November	9805	1,918,760	May	17,121	1,204,800
December	15,077	2,932,120			
Total		**7,248,160**	**Total**		**5,894,520**

MLSW data from late 2005 showed that 56,000 applications for disability pension had been filed. There had been decisions for 43,000 cases, of which 23,000 disability pensions were approved.

[22] Comprised of 6% Serb and 2% other minorities, as cited in the most recent report of the Office of Community Affairs, UNMIK.
[23] The Constitutional Framework limits the capacity of the MLSW to collect data on the ethnicity of program participants. This data is collected solely through self-declaration of ethnicity. The data is contained in the MLSW, May 2005 Report.
[24] The data does not appear to show a correlation between the number of recipients and the cost. This is due to the fact that recipients may be eligible for back payments to January in 2004.

A somewhat related pensions program, administered by the Department of War Invalids and Martyrs in the MLSW, pays pensions to war invalids, and families of those who died fighting in the war.[25] This program had a one-time eligibility period, resulting from political pressures from these constituencies, is not integrated with other programs, and has very limited oversight and transparency.

III.6 Implementation Issues

Pillar I startup faced numerous implementation hurdles. The local office of the Kosovo Social Insurance Fund had suffered significant collateral damage from a NATO cruise missile and required rebuilding. A new IT system had to be procured. New procedures had to be designed and implemented, and staff had to be hired and trained.

The eligibility verification process was considerably aided by availability of the universal civil registration and identification system implemented by UNMIK.

Negotiations and agreements with the commercial banks on the principles of account opening, payment procedures, and bank fees were other important components of the implementation effort.

III.7 Challenges

III.7.1 Setting of the Benefit Level

The process for surveying the cost of a food basket does not require the MEF to use average, or extended period data. Rather the MEF, conducts a survey of costs at a single point in time. This has resulted in some statistical distortion. The methodology by which the MEF sets pensions has been subject to freedom in interpretation, resulting in some inconsistencies.

III.7.2 Bank Fees

A fee schedule was negotiated with the commercial banks which pays each bank 5 Euro per year (or approximately one per cent of benefit payments), for each account belonging to a basic or disability pension recipient. The MEF is responsible for payment of this fee. The original agreement with the banks was for a period of two years, after which the fees would no longer be paid. However, in practice, the banks were able to lobby the government to continue the fee payments. Payments continue to date.

[25] As specified in UNMIK Regulation 2000/66.

III.7.3 Fraud Prevention

A significant challenge has been the limited capacity of the MLSW to identify accounts of deceased pensioners and to terminate payment. There is no incentive for family members to report the death of a pensioner, as co-signers on an account are able to continue to collect benefit payments. Kosovo does not have an automatic system for updating its death registry. Family members must apply for, and pay for, a death certificate. As a result, the Kosovo Pension Administration receives very few notices of pensioner death. During the first two years of operation, the MLSW conducted random visits to the homes of pensioners to confirm eligibility. However, this policy was considered insensitive and was highly labor intensive. Beginning in 2004, the MLSW began requiring recipients to report to one of its offices every six months. The policy was unsuccessful in the MLSW's first attempt at implementation. The number of pensioners who reported was so small that the effort was abandoned. A new approach recently has been adopted whereby pensioners are required to sign a form at a commercial bank branch every six months. Those pensioners who do not sign the form are identified for inspection.

III.7.4 Establishment of Doctors Commissions

The MLSW experienced considerable difficulty in contracting medical professionals for the Doctors Commissions, needed for making disability determinations, due to the modest levels of remuneration paid under the public sector compensation schedule. Tenders were conducted repeatedly with limited response. Ultimately, the MLSW has been able to staff the Commissions without adjusting salary scales. However, difficulties continue with frequent resignations. The MLSW conducts inspections of the Doctors Commissions. In 2005, the head of a regional Commission was released due to irregularities discovered during an inspection. Early data showed that slightly more than 50% of disability applicants were approved for a pension (23,000 out of 43,000).

IV Pillar II

Pillar II of the pension system is a mandatory, defined-contribution, savings pension program. Under this program, all working, habitual residents of Kosovo[26] are required to contribute 5% of gross earnings to the pension trust. Employers, in turn, match the payment with an additional 5% contribution. The mandatory component of the program has age limitations. The regulation states that contributions are mandatory for all workers who are 18 years of age and older, and who were born in the year 1946 or later. The intention of the age restriction was to exempt anyone 55 years of age and older, at the time of program inception, from mandatory contributions, thereby creating a minimum 10 year window during which participants could accumulate savings. Workers who are born in 1945 or earlier are entitled to participate in the program on a voluntary basis. An

[26] As defined by UNMIK for the purpose of issuing UNMIK identity cards.

additional voluntary component of the program allows workers and employers each to contribute an additional 10% of gross earnings to the Trust.[27]

A ten percent mandatory contribution rate was chosen because it was thought that this level would best balance the following objectives. It would:

- be high enough to provide a reasonable replacement rate for a mandatory system (particularly when complemented by the basic pension);
- lead to a funded pillar large enough to attain economies of scale given administrative costs;
- be large enough to crowd out the possibility of any potential future payroll tax for a contributory PAYG component; and,
- still keep overall taxes and social contributions on labor low enough to avoid shadow economy incentives or increases in unemployment.

The Kosovo Pension Savings Trust was created to administer the savings pension program. All contributions are transferred to the KPST, which is responsible for tracking contributions, investing pension assets, and arranging for the payment of pensions. The KPST creates an individual account for each plan participant, and credits the account accordingly throughout the working life of the participant.

Given that the program is defined-contribution, the pension payable at retirement is dependent upon working life contributions and investment return, net of management costs. At retirement, the balance of funds in an individual's account is to be used to purchase an annuity, provided that the accumulated balance is sufficient to meet the minimum threshold.[28] Where funds are insufficient to purchase an annuity, the regulation provides for the payment of a lump sum benefit. However, the KPST Board is investigating options for avoiding lump sum payments through the implementation of a phased withdrawal system, possibly administered through the banks.

Contributing participants become eligible for a pension at age 65. The only exceptions to this rule are in the cases of disability or death. Where a participant is able to provide certification of total and permanent disability prior to age 65, the balance in his/her KPST account is converted to an annuity (provided sufficient funds have been accumulated, as per the old age pension; alternatively, a lump sum payment is made). Where a participant dies prior to age 65, the balance in his/her account is transferred to one or more beneficiaries.

The defined contribution scheme was implemented in two phases. In August 2002, contributions became mandatory for employees of the public sector, public enterprises,

---

[27] This results in a minimum monthly contribution of 10% of earnings and a maximum of 30%.

[28] The Pension Regulation 2001/35 set a threshold amount of 2000 Euro, above which an annuity must be purchased. Policy makers later recognized that the threshold amount is dependent upon the market, in that the threshold should be the amount required to purchase the lowest cost annuity available. As a result, the 2005 regulatory amendment reflects this reality and tasks the KPST and BPK with establishing the threshold amount, to be revised as needed.

socially owned enterprises, and private enterprises with 500 or more employees. In August 2003, the mandatory component of the program was expanded to cover all workers, including the self-employed.

IV.1 Kosovo Pension Savings Trust

The Kosovo Pension Savings Trust was created with the sole mandate of administering the savings pension program in the best interests of contributors. In order to ensure objectivity and compliance with fiduciary responsibilities, the KPST was established as an independent trust, with the power to manage and invest funds prudently for participants, and free of political influence.

IV.1.1 Board of Governors

The KPST Board of Governors has a membership of seven, comprising four professional members, one employer representative, one employee representative, and one representative of UNMIK.[29] Under the 2005 regulatory amendment, the UNMIK representative position was identified as a non-voting position on the Governing Board. The pension regulation establishes the minimum standards for each position in terms of experience and expertise. The following table presents the positions and corresponding requirements.

[29] The position representing UNMIK was originally an ex-officio position, filled by the Head of the Central Fiscal Authority (CFA), as per the articles of the Pension Regulation 2001/35. The CFA was an UNMIK organization, established to manage Kosovo's fiscal affairs. With the creation of a Ministry of Economy and Finance within the PISG, and the gradual transfer of powers to the MEF, the CFA ceased to exist at the end of 2003. The 2005 regulatory amendment reconstitutes the position as a representative of UNMIK, appointed by the SRSG.

Board Member Position	Experience Required
Professional Member	A minimum of 10 years of experience in one of the following areas: 1. An employee, owner, trustee or professional advisor of an asset management company, insurance company or a pension fund with a total value of at least fifty million (50,000,000) Euro under management; 2. An economist or financial analyst with a major international financial institution; 3. An employee of a state pension regulatory body that regulates funded pensions or of a state legislature working on pension legislation; and 4. A distinguished scholar in the fields of economics or finance with a record of extensive internationally recognized academic research and writing relevant to private pension investment.
Employer Representative	Must have professional experience in representing or advising employers in Kosovo.
Employee Representative	Must have professional experience in representing or advising employees or their representatives in Kosovo.
UNMIK Representative	An official of UNMIK, as identified by the SRSG.

The first Governing Board member selection process took place in early 2002 under the conditions set forth in pension regulation 2001/35. Accordingly, the Central Fiscal Authority (the UNMIK body responsible for fiscal affairs) and the permanent secretary of the newly created Ministry of Economy and Finance, under the Provisional Institutions of Self-Government, led the international and domestic recruitment processes. Six Board Members were selected for recommendation to the SRSG. Prior to recommendation, the BPK (Pension Regulator) reviewed the candidate backgrounds and certified suitability. Following mandated consultations with the PISG, which supported the nominations (and with counsel from UNMIK economic advisors), the SRSG appointed the six members and identified a Chairperson.

Given that the CFA ceased to exist at the end of 2003, the 2005 regulatory amendment changed the Board Member selection process. A Selection Committee was created to recommend reappointment or new candidates to the SRSG for vacant positions on the KPST Board. The Selection Committee is comprised of the Managing Director of the BPK (Chairperson), the Auditor General of Kosovo, and the Permanent Secretary of the Ministry of Economy and Finance. The Selection Committee is responsible for considering Board Members for re-appointment and for recruiting for vacant positions. The Selection Committee recommends candidates to the SRSG, who consults with the Economic and Fiscal Council (a body with joint UNMIK and PISG representation) prior to making appointments. It remains the responsibility of the BPK to certify the suitability of the candidates prior to recommendation to the SRSG.

The pension regulation provides that each Board Member is appointed for a three-year term. However, in the case of the initial appointments, in June 2002, three Board members were appointed for two-year terms, in order to initiate the staggering of terms. Due to delays in the approval of the 2005 regulatory amendment, and to the elimination of the CFA, Board Member appointments were not made in June 2004. Rather, the SRSG extended the terms of the two-year appointments on a continuing basis until new selection procedures were established.

One of the challenges of filling the professional Board Member positions is the lack of sufficient experience in the required areas of expertise within Kosovo. The pension regulation does not specify whether Board Members should be domestic or foreign experts. At present, all four professional Board Members are foreign experts, while the two representative members are domestic experts. It is anticipated that this will continue until such a time as the required professional experience becomes available within Kosovo. Board membership for the initial three years is presented in the following table.

Position	Name	Experience
Professional Member	Neil McPherson[30]	Standard Life Investments, responsible for European development (Edinburgh). Previously, 23 years with Citigroup (last position: European Director of Citigroup Asset Management's Global Retirement Services Group)
Professional Member	Harvey Kember	Hogg Robins, Employee Benefits Advisory Group (London)
Professional Member	Steven Bates	Director for a number of asset management companies. Former Managing Director of JP Morgan Fleming Asset Management (London)
Professional Member	Estelle James	Pension policy and administration expert. Former lead economist at the World Bank. Led the team that authored "Averting the Old-Age Crisis." (Washington, DC)
Employer Representative	Basri Jupolli	General Secretary, Kosovo Chamber of Commerce

[30] Neil McPherson is the Chairman of the Board.

Employee Representative	Nexhmedin Shaqiri	Formerly involved with the Independent Union of Workers
UNMIK Representative	Michael Ives / Desislava Borkowska[31]	Head of Central Fiscal Authority / Advisor with the Office of Fiscal Affairs, UNMIK EU Pillar

In 2005, all Board Members completed their initial three-year appointments and stood for reappointment consideration. The Selection Committee, as created by the amended pension regulation, agreed unanimously to reappoint the four professional Board Members. This is considered a strong endorsement of the approach taken in the first selection process, to appoint foreign pension experts until such time as the required expertise is available within Kosovo.

The Selection Committee opted to replace the Employer and Employee Representatives. The new appointees are as follow:

Position	Name	Experience
Employer Representative	Mustafe Pllana	Former Chief Executive of Mitrovica Municipality; Current University lecturer.
Employee Representative	Ali Dragusha	Vice President of the Kosovo Union of Trade Unions.

The UNMIK Representative remains unchanged. All new and reappointed Board Members were appointed for three-year terms.

As allowed in the pension regulation, all Board Members, with the exception of the UNMIK representative, are compensated at a rate that is in line with international standards for similar positions, as approved in the KPST's annual budgeting process.[32]

The Governing Board was required to meet not less than every three months during 2002 and 2003, and not less than every six months in each subsequent year. The Board met three times in 2004 and twice in 2005. For the first three years, all meetings were conducted in Pristina, the capital of Kosovo, and were followed by public meetings/press conferences to allow Board Members to interact with stakeholders. Governing Board public meetings also have been conducted in the regions, including multiple meetings in Serb minority enclaves.

[31] Initially Michael Ives sat on the Board in an ex-officio role as the Head of the Central Fiscal Authority. He was succeeded by Desislava Borkowska, advisor with the UNMIK Office of Fiscal Affairs, following dissolution of the Central Fiscal Authority.

[32] The annual KPST budget must be approved by the SRSG.

IV.1.2 Fiduciary Responsibility

The Governing Board members and the Managing Director of the KPST have a fiduciary responsibility to manage pension assets in a manner that is prudent and solely in the interests of participants. Given that this fiduciary responsibility represents a legal obligation, and perceived breaches could lead to court action, it is standard practice for an organization such as the KPST to hold fiduciary insurance[33] to protect its Board Members and senior executives. Securing fiduciary insurance for the KPST proved to be a challenge, due to both the tightening of the global insurance market and the lack of awareness of the KPST in western insurance markets. The KPST was forced to operate without insurance for its first nine months of operation. In 2003, insurance was secured through a broker in the UK. The insurance is provided by Lloyds of London, and it covers Board Members and the Managing Director against any legal action (legal fees and settlement amounts) that is not the result of criminal fraud or gross malfeasance.[34] The cost of the insurance is significant, and has risen as coverage limitations have been increased in line with the increasing base of assets under management. Coverage and costs are presented below:

Fiduciary Insurance Costs

Year	Coverage Limit (Euro)	Cost (Euro)	% of Annual Expenditures	% of Assets Under Managment[35]
2003[36]	3.5 million	15,461	2.05%	0.044%
2004	5.0 million	37,950	2.68%	0.047%
2005	10.0 million	60,720	4.98%	0.043%
2006	10.0 million	60,720	3.3%[37]	N/A

IV.1.3 Staffing

Employee salary norms in Kosovo in 2002 were very diverse, reflecting the unusual employment environment caused by a heavy international donor presence. The average public sector salary was approximately 150 Euro per month, compared against salaries paid by donor agencies that ranged up to 1000 Euro per month, and higher for skilled and foreign trained employees. Many of the higher paid workers were young people with strong English language skills. The banking sector was forced to compete with the donor community to attract high quality staff.

[33] Also called Directors and Officers Insurance.
[34] For example, Board Members and MD would be covered in the instance where a member or group of members takes legal action over the contention that investment returns are lower than expected, as long as criminal fraud and gross malfeasance are not factors.
[35] AUM balance at December 31.
[36] April-December 2003.
[37] Percentage of 2006 budget.

In planning to staff the KPST, the Board of Governors and its advisors agreed to hire a small staff of highly motivated individuals, who would be compensated on par with other financial sector organizations in Kosovo. Given the absence of organizations such as investment trusts in Kosovo prior to 2002, appropriate skills and experience were not present within the labor force. It was decided to hire staff members who were intelligent, driven, willing to learn, and who had strong language skills in Albanian, Serbian, and English. As a result, 25 staff members were hired, the majority of whom were younger than 30 years of age. A premium is paid for staff management experience and for hard skills in the areas of accounting and information technology.

In recruiting for a Managing Director, the Governing Board felt it necessary to identify an individual who was both Kosovar and who had experience working in the financial sector in a market oriented environment. The Board sought to tap into the Kosovar diaspora through the international media and appropriate web sites. An advisor was appointed as Acting Director until a suitable candidate was identified and contracted. The Board succeeded in hiring a Kosovar Albanian who had lived in the United Kingdom for 12 years, was university educated in London, had worked in the UK pension industry, and was interested in returning to Kosovo to contribute to the post-war rebuilding efforts.

IV.1.4 Organizational Governance

The Governing Board of the KPST is tasked with overall responsibility for ensuring that the Trust is governed in an appropriate manner, in the interests of contributors.

As part of this responsibility, the Board recommends to the SRSG an annual budget of expenditures and an annual administrative fee to be charged against the assets of the Trust. The SRSG is responsible for reviewing and approving these items. In the case of the budget, the Board is authorized to transfer between lines of the approved budget, as needed and within the overall budget ceiling, with the exception of the budgetary line covering Board Member compensation, which cannot be revised following SRSG approval. See “Section IV.16” for further details on administrative costs.

The Board also recommends to the SRSG the by-laws of the KPST. The SRSG is responsible for reviewing and approving the by-laws.

The BPK regulates the KPST. The Board of Governors reports to the BPK and is required to abide by the BPK’s Pension Rules pertaining to the KPST. See “Section IV.2” for further details on the BPK regulatory responsibilities. This role is somewhat innovative. In most countries with a similar system—a centralized, parastatal DC scheme, such as a provident fund—there is no supervisory role for the central bank. Introducing BPK supervision adds a layer of supervision and regulation compared to other similar systems.

In terms of audit, the Board of Governors is required to provide for an independent audit of KPST finances and operations on an annual basis, the result of which is provided to the BPK and is made available to the public.[38] The KPST contracted Ernst & Young from its Greek and Macedonian offices to conduct audits for financial years 2002 and 2003. Grant Thornton has been contracted to conduct the 2004-2006 audits from its offices in Macedonia. In 2005, the KPST implemented an internal audit function to more regularly review the operations and finances of the Trust.

The KPST meets most of the best practice criteria identified in Carmichael and Palacios (2003), "A Framework for Public Pension Fund Management."[39] Specifically:

- The roles of the respective parties involved with the pension system are clearly defined in the pension regulation.
- The terms of appointment and termination of Governing Board members are clearly established in the pension regulation.
- The KPST is well protected against deliberate manipulation by the government through the establishment of Governing Board independence in the pension regulation.[40]
- KPST management is open and transparent about its governance structures.
- The KPST is open to periodic review through independent audit, internal audit, and regulatory inspection.
- The KPST is regulated by the same body as all private pension schemes and is held to the same governance standards as private funds.

IV.2 Regulatory Authority

The authority to regulate the KPST rests with the BPK, which is the overall regulator of financial services in Kosovo. The BPK has far ranging powers that allow it to oversee the operations of the Trust to ensure that the best interests of participants are being met.

The KPST is required to provide regular reports to the BPK, including: audited annual account statements of assets and liabilities, and income and expenses; quarterly statements detailing the sale and acquisition of pension assets; annual statements of the value and allocation of pension assets; annual statements of fees paid to providers of financial services; asset disclosure information by members of the Governing Board (this is confidential information and is only sent to the BPK); and any other reports that the BPK finds necessary. With the exception of the Board Member asset disclosure statements, all other reports are also sent to the SRSG and are made available to the public.

Other areas of BPK responsibility are to regulate how the KPST calculates investment return, and how it reports to participants on an annual basis.

---

[38] See www.kpst.org/English/Documentet/ for Annual Reports.
[39] Carmichael and Palacios, p 16.
[40] It remains to be seen how well the current level of political insulation will be maintained going forward through expected changes in Kosovo's governance.

As the regulator of financial services providers in Kosovo, the BPK is responsible for regulating any asset manager or custodian contracted by the KPST within Kosovo. If the KPST contracts a financial services provider outside of Kosovo, that provider must be regulated by an appropriate regulatory body in an OECD country. The BPK is responsible for ensuring that the foreign provider is appropriately regulated in its jurisdiction. In this regard, the BPK effectively outsources its regulatory responsibility in this area to its counterpart organization in an OECD country. This is an effective means of dealing with regulation in a territory where regulatory capacity is limited.

At the benefit payment stage, the BPK is responsible for licensing and regulating annuity providers in Kosovo. If domestic annuity providers do not exist, the BPK is to approve the contracting of a foreign provider by the KPST, after ensuring that it is adequately regulated in its home jurisdiction.

The BPK has authority to inspect the KPST. It is backed by enforcement authority, as detailed in the pension regulation. The regulation provides for immediate actions in extreme emergencies or for referral to the SRSG for appropriate action. The SRSG and UNMIK therefore remain the ultimate authority for the Trust.

IV.3 Collection of Contributions

IV.3.1 Unified Collection

Early in the policy development stage a decision was taken to pursue a strategy of unified collection, whereby the Tax Administration of Kosovo (TA) would assume responsibility for the collection and enforcement of pension contributions. The objective of the policy was to take advantage of the TA’s extensive network of regional offices and staff trained in collection, audit, assessment and enforcement. This approach allowed the KPST to develop as a centralized institution, with one office in Pristina and a relatively small staff size, thereby maintaining a low administrative cost base.

As a part of its responsibilities, the TA was tasked with defining the contribution collection rules within the framework provided by the pension regulation. This included defining minimum contribution amounts,[41] specifying payment procedures, creation and distribution of forms, and defining the standards for interaction between participating organizations (e.g., commercial banks).

The process of implementing unified collection proved to be challenging. See “Section IV.18.10” for further discussion.

[41] The TA applies its minimum wage rules to the assessment of pension contributions. Any full-time worker who is earning less than the official minimum wage, must make his/her contribution based on the minimum wage.

IV.3.2 Collection Procedures

There are three distinct processes for the collection of pension contributions, depending on whether the employer is a quarterly reporter, monthly reporter, or is self-employed. In all cases, the employer is responsible for deducting the employee's mandatory 5% contribution from salary payment, for matching the 5%, and for processing payment and reporting on behalf of the employee. Firms generally are required to report individual contributions on a quarterly basis. Particularly large firms are encouraged to report on a monthly basis.

For quarterly reporters, the employer is required to complete a monthly declaration form that provides aggregate information on the total payment from the employer. The employer provides this form and payment to any commercial bank branch by the 15th of each month (for the previous month's contributions). The commercial bank transfers payment to the account of the KPST at the BPK. The monthly declaration form is transferred to the Tax Administration, which uses the form to reconcile the aggregate payment. Each quarter, the employer is required to provide payroll information and a quarterly, detailed report to the TA. The quarterly report contains information on all employees, including the total sum of contributions during the quarter for each employee and the employee's personal information, such as the unique identification number (ID). The TA uses the quarterly report information to reconcile the quarterly sum of contributions for each employee against the monthly payments from the employer during the quarter. Once the TA has reconciled the quarterly accounts, and verified the names and IDs of employees, contribution data is transferred to the KPST.

While the pension regulation provides for the quarterly reporting process, the KPST has implemented an alternative monthly reporting process for employers who choose to participate. Monthly reporters provide an electronic payroll file to the KPST following the close of each month. The KPST verifies the employee personal information and generates a declaration form for the employer (and/or an exception report identifying errors). The employer provides the declaration form and payment to any commercial bank branch, as part of the above-described standard payment process. At quarter end, the KPST generates a quarterly report and submits it to the TA on behalf of the employer. This ensures compliance with the regulation, and meets the needs of the TA reconciliation system. The quarterly account is only officially considered reconciled after the TA processes the data and returns an approved file to the KPST.

The monthly reporting process is most useful for large employers, such as the Ministry of Public Services that processes contributions on behalf of more than 75,000 public sector employees. The process provides for the electronic transfer of payroll information and it allows the KPST account officers to work more closely with the employer on issues such as employee name consistency and the provision of legitimate IDs for all employees. This was particularly beneficial during the start up phase of the system, when payroll data from many institutions was of poor quality. As of May 2006, 400 employers were reporting to the KPST monthly, representing 49% of the KPST's individual participants.

Self-employed individuals are required to contribute both the 5% employee and 5% employer contributions on their own behalf. More specifically, self-employed individuals who pay income tax based on gross receipts, minus allowable deductions, must contribute a minimum of 10% of the net amount (and up to 30%, allowing for 20% voluntary contribution). Self-employed persons, who pay income tax on a presumptive basis, must contribute a minimum of one-third of the presumptive tax amount.

Self-employed individuals are only required to make payment quarterly. A self-employed contribution form is completed, including all personal information. The form is submitted to any commercial bank branch with payment on a quarterly basis. The bank transfers payment to the KPST's account at the BPK and sends the form to the TA. As in the other cases, the TA is responsible for reconciling and verifying the account and for transferring the approved data to the KPST.

The KPST is considering proposing a legislative amendment that would require all employers to shift to monthly reporting, directly to the KPST, by the end of 2007.

IV.4 Record Keeping

IV.4.1 Role of Tax Administration

In addition to the reconciliation of payments, the TA is responsible for the upload and verification of data on individual contributors. In most cases, for quarterly reporters, data on individuals are submitted in hard copy. The data must be converted to electronic format and screened for errors or omissions. In particular, files are checked to ensure that a legitimate ID is included for each employee and to ensure that the ID matches with the name provided. The TA chose to sub-contract this work to the Central Processing Centre.

When clean data are returned from the CPC to the TA, the TA reconciles the individual data against employer payments during the quarter. Reconciled and verified data is transferred to the KPST and is kept in an electronic file by the TA.

Where quarterly reports are returned from the CPC to the TA with errors or exceptions (e.g., missing IDs), it is the responsibility of the TA to follow up with the employer to correct the exception. In practice, KPST assists the TA by providing staff members to contact employers to process exceptions. Once exceptions are cleared, the data is resent to the CPC for verification, and the cycle continues until all data is verified and a clean file is provided to the TA.

IV.4.2 Role of the Central Processing Centre

The Central Processing Centre (CPC) is an administrative body created by UNMIK to process the UNMIK ID, a province wide identification card for all Kosovars. In its capacity as the issuing body for UNMIK IDs, the CPC maintains a database of personal information on habitual residents of Kosovo.

As a subcontractor to the TA for pension contributor data processing, the CPC is responsible for inputting all hardcopy data into electronic format. Once in electronic format, the data on each individual contributor is checked against the CPC database to ensure that a legitimate ID is provided,[42] that the ID matches the name provided, and that the spelling of the name is consistent with the database.

Where errors are found, the CPC provides an exception report to the TA. As described above, the KPST assists the TA with contacting employers to clear exception cases.

IV.4.3 Role of the KPST

While KPST staff members assist the TA with cleaning data, the primary role of the Trust is to receive clean data for reconciled employer accounts from the TA. The KPST IT system has been designed to recheck the data provided from the TA for verification and reconciliation purposes. Once rechecked, the data can be attributed to the accounts of contributors.

The KPST maintains a database of individual accounts. One account is opened for each participant. The participant retains the single account throughout his/her working life, regardless of employment changes or periods of unemployment. For each quarter that clean data is provided by the TA, the account of each individual is credited for contributions as presented in the employer’s quarterly report. A historical record is retained for all transactions on an individual’s account.

In addition to contribution data, the KPST records data on date of birth, place of residence, mailing address, and beneficiary designation. Investment income and administrative costs are reflected in the KPST unit valuation.

IV.4.4 Unique ID

To have a robust system of individual accounts, the KPST uses a unique ID as the key to effecting change on an account. An account cannot be created for a participant without the provision of a legitimate, unique ID. Similarly, changes cannot be processed to the account without the verification of the legitimate, unique ID.

The KPST was fortunate in that it was not forced to create its own ID numbering system when it began operations in 2002. UNMIK had initiated the issuance of the UNMIK ID, creating the opportunity for the KPST to use the existing system. The potential downside of the UNMIK ID system was that not all Kosovars were willing and able to obtain an ID number. In many cases, minority groups, such as the Serb community, refused to participate in the UNMIK initiative. Others were not able to prove their residency due to lost or destroyed documents. To address this concern, the TA created its own individual tax number (ITN), supplementing the UNMIK registration system, such that the two

[42] The ID numbers contain a control digit to ensure validity.

numbers are jointly unique. Any working resident of Kosovo is required to obtain an ITN for wage tax payment purposes.

As a result, the KPST is able to apply a unique ID numbering system by requiring all contributors to provide either an UNMIK ID number or an ITN.

IV.4.5 System Requirements

The requirement to maintain an individual account for each participant resulted in the need to develop or procure an IT system with a stable database, capable of processing a high volume of financial transactions.

Given the pressure to implement the savings pension program quickly, the resulting timeline did not allow for the implementation of an IT system prior to the introduction of the program and the initial receipt of contributions. In the short term, the KPST retained contribution data in Excel and Access files, storing the data for allocation to individual accounts in the new IT system, once fully installed. This was facilitated by the fact that fewer than 300 employers participated in the first phase of the program implementation. It was also recognized that the Tax Administration safely stored all collected data in its database during this period.

The development or procurement of a stable IT system became one of the principal priorities for the KPST during its inception period.

IV.5 IT development

IV.5.1 Procurement Options

In considering how best to implement an IT system, KPST advisors researched both procurement and development options. It was discovered that packages existed that could have been adapted to meet the needs of the KPST. However, the packages that were investigated represented significant investments of up to two million Euro for licensing alone. In comparison, it was estimated that a system could be developed in Kosovo, at a cost of Euro 200,000 – 300,000. The off-the-shelf software packages generally had far greater functionality than the KPST needed initially. Given this, and given financial constraints, it was agreed to pursue the development route. An international tender was conducted for the development of an IT system centered around a database, developed with Microsoft SQL Server tools.

In order to finance the IT system development and early program start up costs, the Central Fiscal Authority allocated a subsidy of Euro 511,000 to the KPST.

IV.5.2 Development Costs and Timeline

The procurement tender resulted in the selection of a bid from a partnership between a local software development company and an international provider. The contract specified a six-month system development period, at a total cost of Euro 390,000, of which Euro 125,000 was for hardware purchases. The development project began in August 2002, the same month that the KPST began collecting its first contributions.

IV.5.3 Implementation Process

Significant challenges were experienced in the development of the IT system. The challenges resulted from the inadequate provision of resources on the part of the developers in the early stages and the insufficient identification of business processes on the part of the KPST. The result was a development process that stretched on for 2.5 years and saw a considerable degree of business process and programming revision to meet the needs of changing operational realities. By December 2003, the system contained enough completed modules to allow for the upload of contribution data for the first five months and for the generation of the first participant account statements.

The initial development contract was completed in February 2005, and was followed up immediately with a contract to process system modifications, which are ongoing. The KPST retains full ownership of all source code.

For further information on the challenges associated with IT development, see Section IV.18.9.

IV.6 Program Coverage

IV.6.1 Phased Implementation

The implementation of the mandatory savings pension program was conducted in two phases:

1. Phase 1: Contributions became mandatory for employees of the public service, publicly owned enterprises, socially owned enterprises, and private enterprises with 500 or more employees
2. Phase 2: Contributions became mandatory for all other working residents of Kosovo, including the self-employed.

Phase 1 was originally scheduled for implementation in March 2002. However, due to operational realities, the start date was postponed originally to June 2002, and finally to August 1, 2002. Phase 2 was implemented on August 1, 2003.

IV.6.2 Overall Coverage

The following data show the level of coverage provided by the savings pension system to date:

Date	Employers[43]	Employees[44]
December 2002	278	87,333
June 2003[45]	401	97,217
December 2003	11,262	144,977
June 2004	13,622	158,224
December 2004	14,993	168,718
June 2005	17,135	225,170
December 2005	18,319	235,420
June 2006	18,748	235,442

Due to challenges with data availability, it is difficult to determine accurately the coverage rate for Kosovo. Demographic estimates place 58.7 percent of the total population in the 15-59 years age bracket.[46] This percentage translates to approximately 1.1 million people. Using this number as an estimate for the working age population, the June 2006 participation level results in a coverage ratio of approximately 21 percent of the working-age population.

Less is known about the employed labor-force, earning wage income (which is the target population group for KPST contributions). As a very rough estimation, using the World Bank's Macedonia labor force participation rates for males (73% of working age population) and females (48%), the wage earning population could be estimated at 750,000. Using this estimation, the coverage rate in June 2006 was approximately 31 percent.

However, the accuracy of this estimate is considered very limited. In reality, the labor force participation rate is likely substantially lower in Kosovo than in Macedonia. A significant portion of the working age population has dropped out of the labor force due to scarcity of work and is sustained by remittances from abroad and other types of passive income from the international community. Further, the size of the informal sector in Kosovo is unknown, but it is assumed to be significant. Traditionally, Kosovo has had a much higher share of the labor force in the informal sector or micro-enterprises than Macedonia or the rest of the former Yugoslavia, partially related to the exclusion of

43 Excludes self-employed.

44 Includes self-employed. This data reflects the number of employees for whom valid IDs have been received. It represents the number of participant accounts that have been opened in the KPST database. Contributions have been received for additional individuals for whom ID has not yet been received or validated. In this case, contributions are tracked using dummy IDs in a temporary account.

45 Prior to the Phase 2 expansion of coverage.

46 Source: Kosovo Demographic and Health Survey 2003, Preliminary results. Draft chapters, April 2004.

Albanians from formal-sector jobs during the Milosevic era. Also, labor participation rates of women may be much lower in Kosovo than in neighboring countries, perhaps for cultural reasons.

By comparing records on KPST contributions with personal income tax payments, and with other economic analyses, it is believed that a high share of formal-sector wage-earners are covered by the KPST. That is, KPST seems to cover generally the same people for whom personal income tax payments are made. Problems with coverage therefore have less to do specifically with KPST collection processes and incentives and more to do generally with the problem of informality. Over coming years, increasing KPST coverage will remain a key objective.

IV.6.3 Minority Coverage

Data are not available to determine the extent to which minority groups are participating in the new system. However, interaction with the Serb communities indicates that the rate of compliance for Serb enterprises is low. Whereas there is participation of Serb individuals who are employed by participating entities, such as the public service or large SOEs, there is reluctance on the part of Serb businesses to comply with the mandatory requirements. Initial meetings led to optimism that participation in the program would be supported by local Serb leaders. However, subsequent discussions have revealed that many Serb businesses continue to participate in the pension system run by Belgrade, and that a transition to the Kosovo savings pension system would require authorization from political leaders in Belgrade.

IV.7 Public Sector Coverage

IV.7.1 Ministry of Public Services

The Ministry of Public Services (MPS) manages an integrated public sector payroll system that incorporates all administrative and functional units that are financed from the central budget, including entities such as schools and hospitals. The total number of employees who are processed through the MPS payroll is 75,513[47], or approximately 32% of all KPST participants. To facilitate the processing of payroll for such a large and widely dispersed group, each regional and ministerial unit has a payroll division that provides to MPS Payroll Unit a detailed record of names and wages for all employees. This information is consolidated into a single database and, on a monthly basis, a set of aggregate payment instructions is generated: one for each commercial bank with individual payment account information; one for income tax payment; and, one for pension contribution payment. In support of the pension payment, MPS provides to the KPST a monthly electronic file containing payroll data.

[47] Data for June 2006. Note that in this month the Kosovo Police Service (KPS) began to be processed through the MPS payroll. KPS accounts for approximately 10,000 employees.

From the outset, it was considered an advantage to have a consolidated system for processing and reporting contributions for public sector employees. However, the system has resulted in significant challenges for the MPS and KPST. See Section IV.18.14 for further information.

IV.7.2 Public Sector Contractors

In view of the fact that contractual arrangements may be used for the purpose of tax and pension contribution avoidance, pension policy in Kosovo mandates that contracting entities must withhold and submit pension contributions on behalf of individual contractors. Initially this resulted in a considerable challenge for the KPST, as budget units processed pension contributions individually, leading to a high volume of small value transactions on the KPST account. Further, the budget units failed to provide supporting documentation on behalf of contractors, making reconciliation impossible. Through intensive work with the budget units, KPST staff members were able to secure the supporting documentation, and to improve the payment and reporting processes. MPS has indicated that it plans to consolidate the payment of contractors under the centralized public payroll management system.

IV.8 Investment of Pension Assets

IV.8.1 Regulatory Requirements

Pension regulation 2001/35 tasks the KPST Governing Board with establishing a set of investment principles and with making investment decisions in the best interests of participants. In defining prudent investment of pension assets, the regulation sets forth the following criteria:

(a) The security of Pension Assets;

(b) Diversity of investment;

(c) Maximum return consistent with security of Pension Assets; and

(d) Maintenance of adequate liquidity.

The regulation clearly states the conditions that must be met for an investment to be considered by the Board.[48] Most notably, the regulation forbids the investment of pension assets in securities that are either unlisted or not publicly traded, including real estate or physical assets that are not listed on organized markets and for which valuation is uncertain.

[48] See Pension Regulation 2001/35, Section 10.

IV.8.2 Domestic Investment Environment

The pension regulation recognizes the secondary benefits of investing a portion of pension assets within Kosovo. However, it does not allow for deviation from the investment requirements in order to do so.

To date, the investment environment in Kosovo remains undeveloped. Securities markets do not exist, sovereign debt has not been issued,[49] property rights are frequently undefined, and corporate governance is in its infancy.

Considerable pressure is being exerted domestically to find a means of retaining some of the pension assets within Kosovo. Placements with domestic banks, for the purpose of long term lending, represent the only short to medium term possibility. However, the Board has confirmed that it will only consider this option in concert with a guarantee from a stable foreign government or inter-governmental organization.

IV.8.3 Investment Policies

In its initial years, the KPST Governing Board pursued a very conservative investment policy. The overall objective of the Board was to show a positive return to plan participants in the first years of operation, in order to gain the trust and confidence of participants. Given the local history of financial institution failure, it was felt that providing account statements to participants, showing contributions and growth of holdings, would significantly increase support for the KPST. Given this position, the Governing Board invested pension assets solely in money markets for the first year and a half of operations. Since early 2004, the Board has slowly begun to transition assets into the equity class, initially with an equity ratio of 30%, and eventually increasing to 55%.

Domestic vs. International

The pensions legislation places no explicit minimum or maximum on investments domestically or internationally, but does set high prudential standards for investments. Given the absence of appropriate domestic investment vehicles, to date the Board has pursued a strategy of investing 100% of pension assets outside of Kosovo. Board members are aware of the secondary benefits of retaining a portion of assets within Kosovo, and are willing to consider domestic options as they become available. To this end, the issue of investment in Kosovo is discussed at each meeting of the Governing Board, as a means of observing progress with the development of the domestic investment environment. With the possible exception of externally guaranteed bank deposits, it is unlikely that appropriate investment products will become available in the short to medium term that would warrant a deviation from the current approach of placing all assets outside of Kosovo.

[49] It is unlikely that sovereign debt can or will be issued within the current state of political uncertainty, and is likely only to be realized if Kosovo is granted the status of an independent nation during final status negotiations.

Pooled vs. Segregated

The Governing Board made a decision in 2002 that it would seek to place pension assets in pooled investment vehicles for the initial years of operation. The logic supporting this decision follows:

- In its initial years, the KPST would not have an asset base large enough to interest an investment manager to offer a segregated service.
- Pooled instruments tend to offer overall investment cost efficiencies.
- Pooled funds offer diversification, in a cost effective manner.

Indexed vs. Active Management

Due in part to the size of the asset base in the initial years (see Section IV.8.8), and in part to the desire to keep management fees to a minimum, the Board has pursued a policy of investing in indexed funds. The efficiency of indexed funds, and the resulting lower management fees, has been especially important for the KPST, given the early strategy of investing primarily in money markets.

In 2006, the Board took its first step away from indexed funds by contracting Schroders and ECM to each take on active fixed income mandates for the KPST.

Hedged vs. Unhedged

The first debate on the issue of currency hedging arose with the decision to invest in an indexed global equity fund in early 2004. At that time, the Board agreed to opt for the unhedged version of the selected fund, in order to benefit from currency diversification. In early 2005, with a decision to increase exposure to equities, the Board assessed the costs of hedging to Euro, and opted to transfer funds to the hedged version, in order to avoid currency risk, given that all contributions and benefits are paid in Euro. This issue continues to be a significant issue for debate within the Board.

IV.8.4 Investment Managers

When the KPST began collecting contributions, in August 2002, an asset manager had not yet been selected. As a result, funds were held in the KPST account at the BPK. In the fall of 2002, a tender process was conducted for the selection of a fixed income manager and an equities manager. ABN AMRO was selected to serve as the KPST's fixed income manager, out of its Amsterdam office. Funds were invested in the ABN AMRO Global Liquidity Fund immediately upon the finalization of contracting. In 2005, these funds were switched to the slightly longer duration IGF Euro Fund.

Contracting an equities manager proved to be a more difficult task. The Board was satisfied with products and pricing offered by two leading European firms. Following failed negotiations with one firm, the Board came to terms with Vanguard Investments, whose European operations are run from Brussels. However, it was not until early 2004, that the Board began to transition a portion of assets into the Vanguard Global Stock Index Fund.

In 2005, the Board decided to pursue a strategy of reducing its liquidity fund exposure, in favor of an active fixed income mandate. A search was conducted and, in May 2006, Schroders and ECM were each given a mandate of approximately 20% of KPST assets to invest in active fixed income investments. Each firm was given a benchmark target of beating EURIBOR.

IV.8.5 Investment Portfolio

The KPST's historical investment portfolio, by proportion of assets, is presented below.[50] Dates represent points at which changes in investment allocation took place.

Investment Fund	March 2003	May 2004	July 2004	March 2005[51]	May 2006
ABN AMRO Global Liquidity Fund	100%	75%	70%		
ABN AMRO IGF Euro Fund				50%	8.8%
Vanguard Global Stock Index Fund (unhedged)		25%	30%		
Vanguard Global Stock Index Fund (Euro Hedged)				50%	50%
Schroders – SISF Strategic Bond (Euro Hedged)					20.6%
ECM – Diversified European Credit					10.3%
ECM – European Credit					10.3%
Total	100%	100%	100%	100%	100%

In March 2005 the Board agreed to increase equity exposure to 50% and to shift funds to the hedged version of the Global Stock Index Fund. At the same time, a decision was taken to transfer all funds from the ABN AMRO Global Liquidity Fund to the ABN AMRO Interest Growth Fund that provides for slightly increased durations and targets slightly greater returns.[52]

All of these decisions were communicated by the Governing Board to the public in both written announcements and in public meetings.

[50] Assumes that 100% of assets are invested with asset managers. Does not factor in new monthly contributions that have not been transferred from the BPK account to the asset managers.
[51] The decision to increase equity exposure to 50% and to shift funds into the hedged fund was taken in March 2005, but was implemented in tranches over the following three months.
[52] Note that in September 2006 the Board agreed to increase the maximum proportion for equities to 55%.

IV.8.6 Investment costs

The KPST's investment costs are comprised of asset management fees, asset management transaction costs, asset management performance fees and international transfer fees.

Asset Management Fees, Transaction Costs, and Performance Fees

The KPST's asset management-related fees are presented below:

Fund	Management Fee (% of assets, annualized)	Transaction Costs (% of funds moved)	Performance Fee
ABN AMRO GLF (pre September 2004)	0.20%	N/A	N/A
ABN AMRO GLF (from September 2004)	0.15%	N/A	N/A
ABN AMRO Interest Growth Fund	0.20%	N/A	N/A
Vanguard Global Stock Index Fund (unhedged)	0.18%	0.15%	N/A
Vanguard Global Stock Index Fund (hedged)	0.18%	0.15%	N/A
Vanguard Global Stock Index Fund (hedged) (from April 2006)	0.18%	N/A	N/A
Schroders	0.5%	N/A	N/A
ECM	0.5%	N/A	On returns above EURIBOR +3%

Note that the KPST negotiated a reduction in fees for the ABN AMRO Global Liquidity Fund in September 2004, in light of the KPST's increased asset base.

International Transfer Fees

Kosovo faces an unusual challenge as a user of the Euro, with no central bank and no capacity to produce money. As a result, the BPK is frequently in the position of having to ship cash in and out of Kosovo. This expense is passed on to the BPK's clients. As a result, the KPST pays a fee of 0.1% of the value of each transfer from the BPK to the asset managers in Western Europe. In 2005, this represented a cost of Euro 52,512, or 4.3% of total 2005 expenditures.

IV.8.7 Unitization

The KPST opted to use a unitization process to account for investment gain and administration charges. The unit price was set at Euro 1.0 at inception, and is re-priced monthly to reflect the impacts of investment income and administration charges for the month.[53] Each month, contributors purchase units that are allocated to their respective accounts.

An advantage of the unitization mechanism is that the KPST is able to separate the reconciliation and investment processes. All collected contributions are unitized at the appropriate monthly unit price and funds are invested immediately, regardless of whether contributors can be identified at that time. When reconciliation is completed, at a later date, units are allocated to the accounts of the appropriate individuals.

IV.8.8 Assets Under Management

The KPST's assets under management crossed the Euro 100 million mark early in 2005, after 2.5 years of operation, and reached Euro 200 million by the end of 2006. The following table shows growth in assets.

KPST Assets Under Management

Date	Assets Under Management (Euro)
December 31, 2002	8.63 million
December 31, 2003	34.80 million
December 31, 2004	79.96 million
December 31, 2005	141.00 million
June 30, 2006	172.20 million

IV.8.9 Participant Investment Choice

The Governing Board has expressed interest in expanding the system to include investment choice for participants. At present there is some degree of reluctance to increase the equity exposure, given that the increased risk would apply to all participants, including those approaching retirement. The provision of choice could come in a number of different forms, but would include at least two investment options, providing choice between relatively more conservative and aggressive portfolios. It could result in the creation of age-related portfolios.

Given that system modifications would be required, alongside a strong public education campaign, it is unlikely that investment choice will be implemented in the immediate term. However, it remains a medium term objective of the Board.

[53] This is a KPST unit. Investment income from all sources is rolled into a single unit price.

IV.9 Net Investment Returns and Factors Affecting Them

IV.9.1 Net Investment Returns to Participants

The investment returns enjoyed by KPST participants have been positive but modest to date (in real terms). Recalling that, in order to build confidence, the Governing Board made the decision to ensure that returns would be positive in the initial years of operation, investments were heavily weighted to money markets in the early years. Initially, this limited annualized returns to 1.8-1.9%, net of fees. Since 2004, the proportion of assets allocated to equities has been gradually increased to the present proportion of 55%, and this has helped to produce higher returns in the years 2004-6.

Nominal investment returns are reflected in the KPST's unit price. Nominal returns are net of the 1% administrative fee, charged on assets, which is used to cover asset management fees, international transfer fees, operational costs, and all other fees and charges. A lean administration has helped to keep administrative costs low. Furthermore, the KPST has benefited from start-up subsidies that have helped to ensure that nominal returns have not been eroded by administrative charges of higher than 1%. The KPST charges no fee on contributions.

Unit prices from inception are presented below.

KPST Unit Prices (net of administrative fees)

Date	Unit Price (Euro)
August 1, 2002	1.0
December 31, 2002	1.00024769
June 30, 2003	1.00313772
December 31, 2003	1.00812496
June 30, 2004	1.01246730
December 31, 2004	1.02088113
June 30, 2005	1.04935100
December 31, 2005	1.1093
June 30, 2006	1.123125

The unit price gives an accurate picture of net nominal returns (returns net of administrative fees).[54] Subtracting out inflation from these nominal returns gives real returns. The KPST's real returns have been volatile, largely due to Kosovo's inflation rate fluctuations since 2002. On balance the KPST is showing positive (though low) real net returns to participants. This is a strong result, particularly given the low (or even negative) real net returns other East European pension reforms showed during their start-

[54] Changes in unit prices give an accurate picture of net nominal returns for a funded system that only has an *asset* fee, since the asset fee by convention is taken out after contributions have bought into shares but before investment income is allocated to accounts. In systems that also have a fee on *contributions*, changes in unit price do not fully reflect net returns because the contribution fees are taken out before contributions are used to purchase shares. Note also that there is a difference between administrative *fees* and administrative *costs*. Fees only give an accurate understanding of costs if they entirely cover those costs. When pension systems are subsidized in various ways, as is often the case, additional analysis is necessary to understand the administrative costs, beyond simply looking at administrative fees.

up years, and also given low real interest rates on international markets since 2002. Nominal and real returns, from inception to September 2005, are presented below.

KPST Nominal and Real Returns[55]

	01-Aug-02	31-Dec-02	31-Dec-03	31-Dec-04	30-Sep-05
Nom. Returns, Cumulative	-	0.02%	0.81%	2.09%	8.61%
Nom. Returns, by Period	-	0.02%	0.79%	1.27%	6.39%
Nom. Returns, Annualized	-	0.06%	0.79%	1.27%	8.52%
Real Returns, by Period	-	-5.67%	-0.78%	2.16%	7.29%
Real Returns, Annualized	-	-17.02%	-0.78%	2.16%	9.72%
Inflation, by Period	-	5.69%	1.57%	-0.89%	-0.90%
Inflation, Annualized	-	17.08%	1.57%	-0.89%	-1.20%
Unit Price	1.00000	1.00025	1.00812	1.02088	1.08614

IV.9.2 Administrative Fees, Costs, Subsidies, and Other Factors Affecting Net Investment Returns

These slightly positive (annualized) real net returns are better than those of most other reforms in the region during their start-up phase. The following paragraphs present and then discuss the returns earned in other East European reforms in comparison to those earned in Kosovo. This section focuses on the net investment returns generated in the initial reform years, for the purpose of comparing the early benefits to participants and their initially apparent incentives to participate in the system. The lifetime impact of various administrative fees on final pension received can be very different than the immediate impact over only the initial years. A few comments are made on the lifetime impact of administrative fees near the end of this section.

In Hungary, the funded pension system yielded positive average annual real returns on assets of 2.1% during the time period of 1998 to 2004 (Central Bank of Hungary, 2005). In Poland, the funded pension system yielded average annual real returns on investment of approximately 3% during 1999-2003 (IMF, 2005, p 62).[56] These rates might be called

[55] The line on "Nominal Returns, Cumulative" gives the nominal returns from the beginning of KPST operations until the indicated date. "Nominal Returns, by Period" gives the nominal returns earned during each period. In some cases, these periods are less than a full year, for instance the first period shown, from 1 August 2002 to 31 December 2002. "Nominal Returns, Annualized" adjusts the partial-year periods (i.e., by multiplying the August 2002 – December 2002 four-month numbers by 12/4, and the December 2004 – September 2005 nine-month numbers by 12/9) in order to estimate a whole-year value. "Real Returns" subtract out inflation—by period and annualized, respectively. Kosovo experienced mild deflation in 2004 and 2005, making the "real" calculations seem quite high.

[56] The data in this IMF report on pension system returns comes from the pension regulator's statistical yearbook (KNUiFE, 2003, Table 2.22). The yearbook uses a definition of returns based on percentage change in unit value of a pension fund's assets, following the definition specified in Polish pension legislation (Law on Organisation, 1997, Article 172). This definition takes into consideration asset charges but not contribution charges. It therefore is equivalent to a *gross* rate of return, as defined in this paper. (The calculation for Kosovo was made the same way, but Kosovo has no contribution fee. Therefore, this problem does not arise.) Chlon-Dominczak (2003) reports a rate of return similar to or slightly higher than what the IMF document reports. She reports 24.4% cumulative nominal returns for December 1999-2002,

the *gross* real rate of return. They take into consideration asset fees but not contribution fees charged to members. They are therefore not directly comparable to the *net* real returns for Kosovo calculated above, which reflect the real returns to participants. The *net* real returns in Hungary and Poland, also taking into account Hungary's and Poland's contribution fees, would be even lower than these *gross* real rates of return. By how much lower is difficult to calculate without micro-simulations of representative workers.[57]

The following chart presents such a micro-simulation to estimate *net* returns for an average worker under the Polish reform. The two columns furthest to the right show the estimated real internal rates of return (IRRs) that participants actually received, according to these simulations, using two different approaches to calculation (as explained in the chart footnote). These *net* returns are lower than the *gross* returns reported above since they take into consideration the contribution fees. The conclusion is that a worker would need to have waited several years before the real net returns on contributions would be positive.[58] One driving factor behind this result is the contribution fee, which is quite large relative to assets in initial years.

---

compared with inflation of 13.3% over the same period. Her figures seem also to be *gross* returns, though not enough information is given to be certain.

[57] Kosovo has no contribution fee. Thus, for Kosovo, *gross* and *net* returns are the same, as defined here.

[58] A similar analysis is provided in the following table, from the Polish Ministry of Labour and Social Policy. This too shows that participants initially lost money by contributing to the pension system and fared worse than had they put their money into bank savings accounts, but that within a few years account balances were earning investment income in net terms and were performing better than savings accounts.

Values of Polish pension accounts, compared with alternative bank savings account

	Sum of contribs. transferred	Value of pension savings			Equivalent of saving in bank savings account
		Average	Lowest	Highest	
12-99	100%	97.8%	96.6%	98.0%	101.3%
06-00	100%	98.9%	97.6%	97.8%	104.3%
12-00	100%	100.5%	101.9%	101.9%	107.7%
06-01	100%	94.4%	95.6%	95.4%	110.9%
12-01	100%	102.8%	99.9%	105.4%	112.8%
06-02	100%	106.1%	101.1%	110.1%	112.8%
12-02	100%	110.1%	105.3%	116.5%	112.6%
06-03	100%	113.2%	107.4%	119.6%	112.1%
12-03	100%	116.7%	110.9%	122.3%	111.5%
06-04	100%	120.3%	115.0%	124.0%	111.2%
12-04	100%	127.3%	122.6%	131.4%	111.2%
06-05	100%	131.1%	124.3%	137.1%	111.1%
12-05	100%	137.5%	131.7%	144.0%	110.8%

Source: Chlon-Dominczak (2006)

Net nominal and real returns in Poland[59]

Year	Cum. Nom. IRR	Inflation	Weighted Inflation	Real IRR (average inflation)	Real IRR (weighted inflation)
1999	-4.0%	1.8%	1.8%	-5.9%	**-5.9%**
2000	-0.6%	10.1%	8.6%	-6.5%	**-9.2%**
2001	1.1%	5.5%	6.7%	-4.7%	**-5.6%**
2002	4.1%	1.9%	4.4%	-0.7%	**-0.2%**
2003	5.6%	0.8%	2.9%	1.6%	**2.7%**
2004	5.4%	1.8%	2.5%	1.7%	**2.8%**

In interpreting these numbers and others in this section, it is important to keep in mind the points discussed below regarding the factors impacting on net returns. It also is important to note that there was a considerable variance in Hungary and Poland in how individual funds performed. In some cases, individuals' assets might have yielded returns significantly higher than these averages.

Many factors impact on net real returns, including the following:

- World market interest rates during initial reform years.
- Country interest rate premiums—i.e., the spreads of rates in East European countries above current world market rates.
- The risk level of assets, for instance related to share of investments in equities vs. fixed income, and domestic vs. international.
- Fees assessed to workers and, related to this, administrative and marketing costs of running a pension system, and the extent to which these costs are passed on to participants in the form of fees (immediately or deferred) or otherwise somehow subsidized.

Country situations vary in terms of these factors and, therefore, in terms of the resulting net returns. Real net returns to participants may be higher if: world market interest rates are higher; or country risk premiums are higher; or the proportion of riskier assets chosen is higher; or administrative costs are lower; or subsidization is higher.

The real net return gives a bottom-line quantification of the *absolute* incentives for individuals to participate in the system (though not regarding *relative* incentives unless they are compared with other opportunities and adjusted for risk). Further analysis is needed to understand *why* real net returns vary—whether due to differences in world

[59] Source: Authors' calculations based on pension system data from Ministry of Labour and Social Policy (2004) and CPI data from Central Statistical Office of Poland. The Ministry has calculated contributions to funded pensions, contribution fees, and growth of pension assets for a representative worker. From these numbers it is straightforward to calculate nominal IRRs. 1999 numbers are for last quarter. 2004 numbers are for first half. Real IRR is calculated in two ways—in one, inflation is averaged over the period; in the other, a weighted average is calculated by weighting each year's inflation figure by relative pension assets that year for a representative worker. (The latter approach reflects that assets accumulate over time. Therefore, inflation levels in later years should be weighted proportionately when converting nominal to real IRRs.) The column furthest to the right reports estimated real IRRs using these weighted inflation numbers. The column second from the right reports estimated real IRRs using unweighted inflation figures. Both alternative approaches yield the same qualitative result: Average real IRRs were negative for participants during the first few years of the reform and then became positive.

market interest rates, domestic rates, riskiness of investments, administrative costs, or extent of subsidization.

In the cases of Hungary, Poland, and elsewhere in Eastern Europe, the returns are low in the initial years partially because of administrative fees and high start-up costs relative to initial assets, and also because of the relatively small size of the funded component. Relatively sizable contribution fees in most East European systems make low net returns almost certain, since these fees will be quite large compared to assets at start-up. Kosovo did not have a contribution fee. Also, in the case of Kosovo, the returns are low in absolute terms partially because the assets have been invested in particularly low-risk investments, by regional standards, which yielded relatively low returns in initial years. Furthermore, world market interest rates were lower during the launch of the Kosovo reform than during other East European reforms.

In the case of Kosovo, positive real net returns were achieved quickly partially due to the support of start-up subsidies (discussed in Section IV.16.3), which facilitated the fee structure. Administrative costs are subsidized in most (if not all) pension start-ups, in varying ways, making it difficult to compare precisely across countries. In some cases, system costs are paid not from the pension fund budgets, but from budgets of tax administration, social-sector ministries, and donors. Often, technical assistance is provided by donors and not paid by participants. Several factors suggest that the level of subsidization in the Kosovo reform was less than in other countries in the region of similar population size.[60] Administrative costs and subsidies are the two main factors influencing administrative fees.

The Kosovo reform was based on a principle of administrative simplicity—one centralized institution collecting all contributions and administering all accounts. This model, compared to a system of numerous competing funds, is a contributing factor to lower administrative costs and, in turn, higher net real returns.[61] Related to this, since

[60] The factors suggesting relatively low subsidization in Kosovo compared to other countries include the following: 1) The extent to which other state institutions, besides the KPST, are involved in collection and reconciliation of contributions in Kosovo is comparatively limited relative to other countries. In Kosovo, collection and reconciliation functions are shared between some staff of the Tax Administration, which is an implicit subsidy, and KPST staff members, whose costs are captured explicitly in KPST administrative fees and direct subsidies. In many countries, the collection and reconciliation process is entirely separate from the pension fund(s), involving large stand-alone agencies, and financed entirely from general revenues, constituting a much larger implicit subsidy than in Kosovo; 2) An absence of earmarked donor loans or grants to fund start-up expenditures, compared to extensive grants and loans in many countries; and, 3) Fewer person-months of technical assistance provided by donors during the reform design and start-up phases in Kosovo compared to other countries. Note it is even more difficult to make subsidization comparisons across countries of widely varying population size. There are significant economies of scale in pension administration. Therefore, one would expect administrative costs (and needed subsidies) to be much higher per participant in a small country than in a large country. This makes meaningful comparisons across large and small countries difficult.

[61] Unlike in many Latin American countries where collection generally was not centralized, in Eastern European reforms the collection of pension contributions has generally been centralized within a state agency. Management of accounts in other East European reforms, however, generally has been decentralized, in competing private funds. The KPST model, with centralized collection and account management, should be more cost-effective than the general East European model of centralized collection

there is only one provider of funded pensions in Kosovo, there is less need for marketing costs. While the KPST does have a budget for public relations expenses, the institution likely spent less on such expenditures than did funded institutions in highly competitive systems. This too would keep costs and, therefore, fees, lower in Kosovo than elsewhere.

To the extent that low returns have been related to system start-up in these countries, real rates of return likely will improve over time. As a result, systems with poor initial performance may still yield favorable returns for participants in the long run, compared to pre-reform systems. Different types of fees have different relative advantages and disadvantages. Fees on contributions have a disproportionate impact on newer entrants to the system. Fees on assets have a disproportionate impact on those who have been in the system longer, since the fee recurs each year. Lifetime impacts can be estimated on the extent to which administrative fees reduce the net return to participants, or, from another perspective, the assets in people's accounts, compared to a hypothetical ideal of a system with zero fees.

Hungarian legislation (January 1998) permits a contribution fee of 5-6% of contributions and an asset fee of 0.6-0.7% of assets.[62] Polish legislation (January 2004) permits a contribution fee of 7.0% and an asset fee of 0.54%. Croatian legislation (July 2003) permits a contribution fee of 0.8% and an asset fee of 1.2%. Estimates suggest that these fees would reduce final assets and yields on investments at the moment of retirement, compared to what they would be without such fees, by 14.4% and 0.65% respectively in Poland, and by 26.4% and 1.42% in Croatia. These are outer boundaries. Due to competition, individual funds might charge lower fees, which would mean that the reduction in final assets and yields could be substantially less for actual investments.

Kosovo legislation does not set the fee level but rather requires that the KPST seek approval each year for the fee. For the purpose of making specific estimates: An asset fee of 1.0% now, declining to 0.6% by 2010, would have a long-term impact of reduction in assets of 12.4% (less than any of the other fee structures permitted in other countries). An asset fee of 1.0% continued indefinitely into the future would have a long term impact of reduction in assets of 19.4%, which is more than the impact in Poland and less than in Croatia according to the maximums set in those laws.[63] (Pension funds in Poland and Croatia that charge fees significantly below the maximums allowable could result in reductions in final assets and yields that are even lower than the projections for Kosovo using a long-term assumption of a 0.6% asset fee.)

---

but decentralized account management. Related to this, the East European model of centralized collection and decentralized account management is more cost effective than the Latin American model of decentralized collection and decentralized account management.

[62] The information on asset and contribution fees and their impact on final assets and yield comes from Anusic (2004) and Chlon-Dominczak (2003). The current Polish contribution fee of 7.0% is to be reduced to 3.5% over at ten-year period. The Polish asset fee is actually more complex than the flat rate of 0.54% presented here—it is lower for pension funds with greater assets.

[63] Authors' calculations, assuming real wage growth at 2%, real interest rates at 4%, and contributions to an account for 40 years. Some back-of-the-envelope estimates suggest that an asset fee incrementally reduced from 1.0% to 0.6% by 2010 should be sufficient to cover administrative costs for the near and longer term.

While these complex issues make interpretation somewhat difficult, an important summary point is that the Kosovo reform achieved positive net real interest rates faster than other reforms in the region. Kosovo achieved this outcome despite the facts that world interest rates were lower during Kosovo's start-up than during other reform start-ups, and that assets in Kosovo were invested in particularly low-risk instruments. One could debate the extent to which various factors contributed to this outcome, but this nonetheless is an important success of the reform.

These issues are important in understanding the Kosovo reform, as they were at the forefront during the design and early implementation of the reform. A sole institution was chosen rather than private, competing pension funds partially in order to keep administrative costs low. A modest asset fee and zero contribution fee were chosen in order to minimally subtract from beneficiaries' returns, particularly in the early years. To facilitate this fee structure, a start-up subsidy was sought from the state budget to cover the initial gap until assets started to accumulate. During the initial implementation years, the Governing Board was careful to invest in fixed-income assets that were most certain to yield a positive real return for participants after fees, even if they might yield lower returns than higher-risk investments could have generated. The positive net real returns that the Kosovo system achieved during the initial years suggest that these design and implementation decisions were successful in achieving their objectives.

IV.10 Reporting to Participants

The KPST issues account statements to participants, providing information on contributions, investment gain, and account balance.

IV.10.1 Reporting Frequency and Costs

Initially, the pension regulation required that the KPST issue two account statements per year. However, an assessment of the level of effort and cost of producing the statements led to a KPST/BPK agreement to reduce the requirement to once per year. This change is reflected in the 2005 regulatory amendment. In 2005, the KPST began the cycle of reporting on a calendar year basis.

To date, the KPST has issued five sets of account statements. The costs have varied considerably due to the volume of statements (the first issuance went to only Phase I participants), and the method of distribution. The most recent issuance, in May 2006, involved 193,000 statements that were mailed directly to participant homes. The total cost of printing and mailing amounted to Euro 57,000, or 3.1% of the 2006 budget. This cost will continue to rise as more participants provide mailing addresses, resulting in a higher distribution volume.

IV.10.2 Statement Distribution

The distribution of account statements has represented a significant challenge for the KPST. Three different means of distribution have been tried.

Initially there were two barriers to mailing statements directly to participant homes. First, an insufficient number of participants had provided mailing addresses to the KPST. Second, the postal system was weak in the early post conflict years, in large part due to changes in street names throughout Kosovo.

For the first issuance, in December 2003, statements were distributed through employers. This was practical only because the issuance was for Phase I participants only. Statements were generated for fewer than 300 employers, all of whom agreed to distribute statements to their employees. In total, 82,224 statements were generated and distributed. This method of distribution did not prove particularly successful. The Ministry of Public Services, with its 67,000 employees, did not have the logistical capacity to distribute statements to ministries, schools, hospitals etc. KPST staff assisted MPS to the greatest extent possible. Other employers were either unable to, or simply did not, distribute statements. In one case, an employer with 10,000 staff members and many regional offices, failed to distribute statements to the majority of its employees.

For the second issuance, in July 2004, distribution through employers was not considered, given the lack of success with the first round, and the fact that the number of employers had increased into the thousands. Because direct mailing was not yet considered an option, a decision was taken to distribute statements through the outlets of the PTK, the post and telecommunications agency. Participants were asked to pick up their statements from the main postal outlet in the region of their employment. This proved to be both costly and ineffective. Printing and distribution for this issuance cost Euro 50,000, or 3.98% of 2004 expenditures. Of 110,003 statements generated and distributed to postal outlets, only 18% of statements were retrieved. The remaining statements were returned to the KPST.

Prior to the third issuance, the KPST ran a public campaign, asking participants to complete and submit personal information forms, containing information such as mailing address and beneficiary designation. A sufficient number of forms were received to justify testing direct mailing for distribution. In December 2004, statements were generated for 130,000 participants, of whom 87,407 had provided the KPST with mailing information. Of the 87,407 statements that were mailed, only 5% were returned as undeliverable. A public education campaign accompanied the distribution, and it encouraged those who did not receive statements to contact the KPST with a mailing address. This method of distribution was judged a success and a decision was taken to use this method to distribute future rounds of account statements.

IV.10.3 Statement Issuance Timeline

The appropriate time lag between the cut off date for transactions and the issuance of account statements has been a source of discussion. Initially, the KPST issued statements with a time lag of nine months. This timing was due, in large part, to the unified collection approach adopted by the KPST. Considerable time is required for contributions to be processed by the Tax Administration and commercial banks. The tradeoff is that the KPST is able to maintain very low administrative costs (if the KPST took over the collection of contributions, the time lag may be reduced, but costs would increase significantly). The KPST has sought to compress timelines as contribution processing has become more efficient. The most recent statement issuance (May 2006), was produced with a time lag of four months.

IV.10.4 Feedback from Participants

The KPST has established a system of dedicated phone lines and operators for information purposes during account statement periods. The call volume has been relatively low, but has grown steadily with each issuance. In general, it is perceived that participants are pleased to receive statements showing proof of their contributions and balances. However, indications were that the average participant had difficulty understanding the content of the statement. As a result, in 2005, KPST management and the BPK regulatory team cooperated in the development of a revised, more user-friendly design for account statements (see revised statement format in Appendix One).

IV.11 Pension Payments

IV.11.1 Anticipated Ten Year Window

The pension regulation specifies that contributions to the savings pension are only mandatory for individuals born in 1946 or later. At the time the regulation was drafted, that meant that workers over the age of 55 were not required to participate in the program. The intent of this provision was to create a 10-year window before which pensions would be paid out, thus allowing for the accumulation of account balances.

In practice, this has not been the case. Experience has shown that several employers, including the Ministry of Public Services, do not have the capacity to filter employees in their payroll systems based on age. As a result, employers have tended to make deductions and contributions on behalf of all employees, regardless of year of birth. KPST 2005 statistics showed that, for the 160,000 participants for whom birth date was on file, 6400 were 60 years of age or older.

There has been a light but growing volume of participants, who have reached 65 years of age, and who are applying for benefits. The KPST began paying out pensions in 2004, in the form of lump sum payments. On average, the KPST pays out 150 pensions per month, although the number has been as high as 600 in a given month.

IV.11.2 Survivor Pensions

When a participant dies prior to reaching the age of 65, the balance in his/her account is transferred to a beneficiary(ies). The KPST conducted a public campaign asking all participants to designate one or more beneficiaries by completing and submitting a personal information form to the KPST. The designation of a beneficiary, however, cannot override requirements in the pension regulation and relevant laws, relating to spousal and family rights. Where a beneficiary has not been designated, the balance on the account of a deceased participant is treated according BPK rules, which are in accordance with the pension regulation and the inheritance laws of Kosovo. A beneficiary is eligible to receive a lump sum payment or to transfer the money owing to his/her account at the KPST.

IV.11.3 Disability Pensions

In the event that a participant is permanently, 100% disabled prior to reaching the age of 65, he/she is allowed to receive early payment from the KPST. Where the participant has reached the annuity threshold amount in his/her account, an annuity must be purchased. Where the balance of the account falls below the threshold amount, a lump sum payment is made to the participant. In order to prove permanent, 100% disability, the participant must present documentation from one of the Doctors Commissions that have been established by the Ministry of Labor and Social Welfare. The Doctors Commissions were established in support of the Pillar I disability pension implementation. As of mid-2006, the KPST had made seven benefit payments based on permanent disability.

IV.12 Annuity Provision and Alternative Payment Arrangements

The pension regulation specifies that, at the age of 65 or in the case of permanent disability, a participant must convert the balance in his/her account into an annuity, assuming there are sufficient funds to meet the threshold amount. The regulation originally set a threshold amount of Euro 2000, below which a lump sum would be paid, and above which an annuity must be purchased. Given that it is not clear that Euro 2000 is sufficient to buy an annuity, the 2005 regulatory amendment mandates the Governing Board to recommend, and the BPK to approve, a threshold amount above which an annuity must be purchased. The Board's task will be to determine at what threshold level it becomes possible to purchase a cost-effective annuity. It is assumed that this threshold level will change over time.

Given that most salaries are very low in Kosovo, and many workers are joining at advanced stages of their careers, there is concern that large numbers of participants will never reach the annuity threshold level, and will qualify for one-time payments. The Board recognizes that the provision of lump sum payments does little to secure the long term financial futures of retirees. As a result, Board members have begun to discuss investigating alternative means of providing phased withdrawals or time-series payments for those participants who are not able to purchase an annuity.

IV.13 Tax Treatment of Contributions and Benefits

Tax treatment is another area where a policy change has taken place since the inception of the savings pension program. Originally, mandatory contributions were treated in the tax laws as EET (exempt, exempt, tax), whereby the 5% employee contribution is pre-tax, investment earnings are tax exempt, and benefits are taxed as regular income. However, voluntary contributions (up to an additional 10%) were not addressed in the original tax provisions, and by default were treated differently, whereby any voluntary employee contribution was deducted from after-tax income. This policy created uncertainty as to how to deal with benefit payments based on funds that were from a mix of taxed and untaxed contributions. It also created operational challenges for the KPST, by creating a need to track mandatory and voluntary contributions separately. Finally, the policy did not encourage long term savings through tax benefits.

Given these issues, the TA changed its policy in the Income Tax Law of 2004 to exempt all contributions to the KPST from taxes. The KPST now works solely on the basis of EET.

IV.14 Public Support/Education

The KPST has committed considerable effort and financial resources to public education initiatives that are designed to help the public and plan participants to understand the role of the KPST. The primary objectives of the initiatives have been to show the public that the KPST is a Kosovar institution, and that its sole mandate is to care for the best interests of its participants. This is no small task in an environment where corruption and the theft of public money are common, where the previous pension fund has defaulted on its obligations, where other financial institutions have not met obligations, and where the population has grown tired of the international presence in Kosovo (the KPST is frequently perceived as an arm of UNMIK).

The KPST has run ad campaigns in the local TV, radio and print media. It has sought interview and talk show space for its Managing Director. It has run poster, billboard, and pamphlet campaigns. It has designed and launched a web site. Most important, significant effort has been dedicated to conducting open, public meetings in all regions of Kosovo, including minority areas.

The most common questions from the public relate to:

- Confusion between taxes and pension contributions;
- Confusion between the pillars of the overall pension system;

- Why the KPST is not paying benefits based on contributions to the old Belgrade pension program, or why it is not forcing Belgrade to meet its obligations;
- Why participants cannot withdraw their money before turning 65; and,
- Why pension assets are invested outside of Kosovo.

The public education efforts appear to have been successful in raising the profile of the KPST, in terms of public awareness of the organization. However, many years of public education lie ahead as the KPST seeks to raise the level of understanding of its operations and policies.

The KPST conducted a public opinion survey in 2005, in order to develop a baseline against which to measure the effectiveness of its public education efforts in future years. In general, the survey indicated relatively positive feelings toward the KPST and its management.

IV.15 Political Support

The KPST has benefited from strong political support from UNMIK, USAID and other donor agencies. Kosovar authorities have provided strong support for the reform overall. However certain specific aspects remain contentious. Of greatest importance, many in the Kosovar Government have pressed for at least some level of investment within Kosovo, while the Governing Board has not yet seen options that would be consistent with prudent investment guidelines. The process of appointing Governing Board members, and the extent to which internationals are on the Board, also has proven controversial. However, in the latest round of Board Member appointments, the Government proved to be supportive of the principle that investment decisions must be undertaken by individuals with relevant professional experience, and it recognized that Kosovo currently does not have such experience internally. Nonetheless, securing the long-term support of the local political establishment remains a challenge.

IV.16 Administrative Costs

The KPST is intended to be self-financing, through an administrative charge against assets. The pension regulation tasks the Governing Board with presenting an annual recommended administrative fee and expenditure budget to the SRSG for approval.

IV.16.1 Administrative Fee

As discussed in Section IV.9.2, pension fund administrative fees can be both complex and expensive for plan participants. The following table presents comparative administrative fees for Pillar II pension funds in four countries.

Administrative Fees[64]

Charges in effect from	Up-front fee (% of contributions)	Management fee (% of assets)	Returns fee (% of returns)	Exit fee (% of assets)	Brokerage fee	Custodian fee
Hungary (second pillar since January 1998)						
Jan 1998	5-6 (on average)	0.6-0.7 (on average)	No	0.2	Yes	Yes
Kazakhstan (second pillar since January 1998)						
Jan 1998	1	No	10	No	No	No
Jan 2003	No	0.6	15	No	No	No
Poland (second pillar since January 1999)						
Jan 1999	8.5	0.6	No	Yes	Yes	Yes
Jan 2004	7.0[65]	0.54	Yes (capped)[66]	Yes	Yes	Yes
Croatia (second pillar since January 2002)						
Jan 2002	0.8	0.8	25	Yes	No	Yes
July 2003	0.8	1.2	No	Yes	No	Yes

Source: Anusic (2004)

In Kosovo, the KPST administrative fee is strictly a charge against assets. The Board policy has been to keep the administrative charge to a minimum, in order to instill trust in the KPST as a management body and ensure that program participants save the maximum amount possible for their future pensions. In each year of operation, the Board has proposed, and the SRSG has approved, an annual administration fee of 1% of assets. The 1% fee covers administrative costs, as well as asset management expenses and international transfer charges. However, in the start up stage, because of the low asset base, the 1% fee has not been sufficient to cover all costs. As a result, subsidies have been used to supplement the 1% fee (see Section IV.16.3).

It is important to note that the relatively low asset management fee has been enabled by two factors in the early stages of the KPST's development: 1) a very lean administrative operation with strong expenditure controls; 2) subsidies. The second factor makes it very difficult to compare costs across countries. In most countries, some form of subsidy has supplemented revenues from administrative fees, but information on the full scope of these subsidies is difficult to obtain, in any comprehensive way.

IV.16.2 Expenditures

The Governing Board has instructed KPST management to keep administrative expenditures to a minimum. The organization has finished each of the last four years under budget. In 2005, the KPST spent Euro 1.218 million, representing 74% of budget. The 2006 budget allows for expenditures of Euro 1.846 million. However, spending was below budget to November.

[64] The table denotes maximum fees permissible under the law. Actual fee levels may vary depending on annual ceilings set by regulators and business decisions of pension companies.
[65] The upfront fee in Poland is scheduled to fall to a maximum of 3.5% by 2014.
[66] The rate of return fee in Poland (called premium account fee) depends on relative fund performance and is subject to a maximum of 0.06 percent of assets per annum.

Apart from asset management fees and international transfer charges, the top five expense categories for 2006 are:

1. Staff salaries (20.5% of 2006 budget);
2. Public education (5.4% of 2006 budget);
3. Trustee honoraria (4.9% of 2006 budget);
4. Account statement production and distribution (3.8% of 2006 budget); and
5. Fiduciary insurance (3.3% of 2006 budget).

IV.16.3 Subsidies

The KPST has received considerable support during its start up stage, in the form of financial and human resources. A public budget subsidy, totaling Euro 3.011 million was allocated to the KPST to cover estimated operational deficits through to the point of self-sufficiency.[67] The KPST is now managing the subsidy money and carries it on its accounts as a deferred subsidy. This approach was deemed preferable to seeking an annual allocation from the consolidated budget.

In terms of human resources, USAID funded two full-time, and two part-time, international advisors to support the KPST for its first two years. USAID support continues with short-term advisors. The EU continues to fund two local positions in support of the KPST.

It should be noted that the use of the TA for collection, enforcement, and reconciliation represents an implicit subsidy from the Kosovo Consolidated Budget.

IV.16.4 Sources of Funding

The following table shows the sources of funding for expenditures in each year of operation:

Sources of Funding

	Total Expenditure (Euro)	Funded by Admin Fee (Euro)	Funded by Subsidy (Euro)	Funded by Admin Fee (%)	Funded by Subsidy (%)
2002	273,000	17,000	256,000	6.2%	93.8%
2003	754,000	219,000	535,000	29%	71%
2004	1,239,000	609,000	630,000	49%	51%
2005	1,219,000	1,133,000	86,000	93%	7%

[67] This figure includes the initial grant of Euro 511,000 to cover the cost of the IT system.

IV.16.5 Projections

Based on the 2006 budget and the rate of growth of the asset base, it has been projected that the KPST will reach the point of operational self-sufficiency in 2007, two years earlier than originally projected. However, given the pace of expenditures (under budget for 2006) it is reasonable to assume that the KPST could achieve self-sufficiency in 2006. It is expected that the funds remaining from the Euro 3.011 million subsidy will be more than sufficient to finance any remaining deficits. The outstanding subsidy balance will be put toward the cost of a new IT system in 2007.

IV.17 Single or Multiple Providers of Pension Administration Services

The pension regulation originally allowed for the licensing of alternative providers of administration services for the mandatory savings pension in 2005. Pension policy advisors, BPK officials, and UNMIK officials reconsidered this issue in 2004. While all parties agreed that competition among providers has some desirable characteristics, the following concerns also were considered:

1. Is the contributor base large enough to sustain more than one provider without significantly increasing administration fees?
2. How would the system work?
3. Would the TA collect contributions and then forward funds/information to providers?
4. Who would track compliance?
5. Would there be one central administrative and record keeping body?
6. If that body were to be the KPST, significant operational and system modifications would be required.

All parties agreed that expanding the system to allow for multiple providers would not be cost efficient or administratively feasible at this stage. This provision was removed from the regulation in the 2005 regulatory amendment. Instead, Kosovo is likely to pursue an approach of offering investment choice within the KPST, for instance by offering various investment portfolios from which contributors can choose. Implementing such changes will depend on developing enhanced administrative and IT capacity.

IV.18 Challenges

IV.18.1 Investment Policy

Investment policy has been the most contentious political issue that the KPST has faced. As discussed in Section IV.8, the KPST currently invests all of its pension assets outside of Kosovo. This is due to the fact that appropriate investment vehicles do not yet exist in Kosovo. However, there is strong pressure to retain the assets in Kosovo, although it is not clear through what mechanism, other than the local banks. It is interesting to note that most of the pressure comes from either local political figures, business organizations, or the local media. Public meetings have not provided evidence that the Kosovo public is strongly opposed to investing outside of Kosovo in the interest of asset security. Nonetheless, this issue will remain a significant challenge for the KPST, particularly when UNMIK considers transferring authority over financial institutions to the PISG.

IV.18.2 Annuity and Alternative Payment Provision

As discussed in Section IV.12, there is concern that many plan participants will never save sufficient funds to purchase an annuity. The two prime factors are low salaries in Kosovo, and receipt of contributions on behalf of participants who are nearing retirement. Further, it is not clear when an annuity market might develop in Kosovo. The Governing Board faces the challenge of devising a strategy to avoid payment of one-time, lump sum pensions. Options for the provision of phased payments are being investigated with the commercial banks.

IV.18.3 Board Membership

Governing Board composition currently includes international experts in the four professional member positions. This is due to the lack of expertise in Kosovo in the areas of pension fund administration and asset management. At times during the last four years, this has been raised as an issue for concern by local political leaders and the local media. At some point in the future, it is anticipated that Kosovars will take over the professional member positions. The challenge will be ensuring that the transition only occurs when the appropriate skills and experience are available within Kosovo.

IV.18.4 Fiduciary Insurance

The KPST faced a significant challenge in securing fiduciary insurance coverage for its Board Members and Managing Director. The two key limiting factors were the tightening of the global insurance market and the lack of awareness of the KPST in western insurance markets. The KPST was forced to operate without insurance for the first nine months of operation, until a policy was secured through a broker in the UK. For further information on fiduciary insurance, see Section IV.1.2.

IV.18.5 Political Transition

UNMIK is progressing with a gradual transfer of administrative authorities to the PISG. At present, the KPST, as a financial institution, has been retained as a reserved power of UNMIK.[68] This means that the SRSG retains the right to appoint Governing Board members, and to approve by-laws, annual budgets, and the annual administrative fee. When authority is eventually transferred to the PISG, the challenge will be to ensure that

[68] This is also true of Pillar III pension funds, as they fall under the authority of the BPK, which is a reserved power. On the other hand, authority over Pillar I has been transferred to the PISG, under the authority of the Ministry of Labor and Social Welfare.

the KPST is maintained as an independent body, free of political influence, with an experienced Governing Board, and with the freedom to invest pension assets prudently.

IV.18.6 Inclusion of Minorities

The KPST objective of ensuring a high degree of inclusion of the Serb minority has met with little success. While there is participation of Serb individuals through employment with organizations such as the Ministry of Public Services, POEs and SOEs, Serb enterprises have generally refrained from participating in the savings pension program. KPST management and staff have conducted public meetings in Serb enclaves and have worked directly with Serb employers and business leaders. However, while there was initial enthusiasm on the part of some business leaders, it has not evolved into participation in the program. There appear to be several hurdles. First, many Serb-owned enterprises still participate in the pension system run from Belgrade and, in some cases, payroll is processed from Belgrade. Second, indications have been that Serb-owned enterprises would require approval from political leaders in Belgrade before they could participate in the Kosovo pension program. Third, there is economic malaise in Serb areas, meaning that unemployment is high, resulting in few Serbs working in regular, wage-paying jobs. There is little analysis to help understand the extent to which the problem lies more in unwillingness to participate or more simply in a dearth of wage-paying jobs for Serbs.

IV.18.7 Decentralized Services Through a Single, Centralized Institution

The KPST maintains a single office, with a small staff of 25, in the capital city of Pristina. A decision was made at inception to proceed with a centralized institution in order to minimize administrative costs. It was agreed that TA regional offices would be the points of contact for participants in the regions. This proved to be a challenge in the early stages of operation, as the TA was not prepared and TA staff members were not sufficiently knowledgeable of contribution requirements. The TA has now appointed 17 staff members to work solely on pensions, of whom 14 are located in regional offices. KPST staff members have worked with the TA officers to improve their level of understanding so that participants receive a high level of care at the regional level. The KPST also conducts public meetings in the regions, in cooperation with the TA. It appears as though the current arrangements are meeting the needs of participants in the regions.

IV.18.8 International Accounting Standards

The KPST received notes on its first two sets of audited financial statements (2002 and 2003) indicating that it was not fully compliant with international accounting standards due to the use of cash accounting for contributions received (rather than accrual accounting). The KPST found itself in a similar state as many national governments which are attempting to convert accounting for national revenues to a system of accruals. The principle challenge is that payments may be received after the close of the financial year, and they are not easily defined. They are referred to as "non exchange transactions". The KPST's original auditors were unable to assist with the conversion to an accruals based system. For the 2004 financial year, the KPST changed auditors and together they have resolved the issue by recording accrued but outstanding contributions for December in the year end financial statements. Apart from December contributions, received in January, any other contributions received after December 31 are not considered material.

IV.18.9 IT Development

As the record keeper for more than 200,000 participant accounts, the KPST has need for an advanced, secure and stable IT system. A decision was taken to develop the system specifically to meet the needs of the Kosovo savings pension program. The process has been long and challenging. When the KPST began collecting contributions in August 2002, data from employers were kept in Excel or Access files. It was assumed that this would be a short-term solution, given that the development contract was signed the same month and was scheduled for six months to completion. However, significant delays were experienced, and the development of the system was not completed until February 2005, a span of 2.5 years.

The reasons for the delays are varied. The three most significant factors were limited resources, changing KPST needs, and interaction with the Tax Admin IT system. In the early stages of development the contractors did not show sufficient commitment to KPST needs. The local firm was committed to other contracts and the international firm appeared to have underestimated the level of work that would be required. Sufficient resources were not allocated to the KPST project. After considerable discussion, the international firm essentially was dropped, from the KPST's perspective,[69] and KPST management insisted that the local contractor's staff relocate to the KPST offices. Relocating the development project to the KPST premises ensured that resources were committed to the project, allowed for a greater degree of supervision, and allowed for more direct interaction with the KPST IT team. The second challenge resulted from lack of preparation on the part of the KPST. In a standard IT development project, business processes are clearly defined before the commencement of programming. In the case of the KPST, due to the tight timelines for implementation of the pension program, the IT programming was taking place at the same time as the development of business processes. This led to considerable frustration on the part of the IT contractors who were frequently required to revise their programming to reflect changing business processes. A third challenge was that the KPST IT system was developed to ensure interaction with the Tax Admin IT system and to be able to accept data according to TA formatting. Unfortunately, the TA was developing its IT system at the same time as the KPST, resulting in confusion and frequent revisions to the KPST system.

The KPST now has an IT system that is functional, but does not have the capacity and stability to support projects such as the implementation of multiple investment portfolios. The Governing Board already has discussed the importance of beginning the process of

[69] The international firm did provide one component of the system that is being used for data exchange and validation.

planning for a new IT system. While no decisions have been made, it is possible that the KPST will investigate options for purchasing an existing software package that can be customized to meet KPST needs. It is anticipated that the project will run parallel to current operations, will take up to two years to completion, and will represent a financial investment of more than Euro 1 million.

IV.18.10 Unified Collection

A decision was taken, in 2001, to mandate the Tax Administration with the collection, enforcement, and reconciliation of pension contributions. It was agreed that this was consistent with international best practices and represented the most cost efficient means of implementing the savings pension program. The challenge with the implementation was that both the KPST and the TA were in their start up phases during the same period. This resulted in considerable confusion and ongoing challenges.

The task of implementing a national tax collection organization is daunting on its own. Adding the responsibility to collect and reconcile pension contributions stretched the capacity of the TA in the early stages. The TA IT system was being built at the same time as the KPST system, resulting in ongoing challenges in ensuring consistency in processes and capacity to interface. Staff shortages were a challenge in the first two years, and buy-in on the part of TA staff, with relation to collecting pension contributions, was low. Pressure from the KPST to progress the reconciliation process led to interpersonal challenges. The net result was a backlog of unreconciled files, stretching back two years.

The two organizations established a task force in 2004 to address the issue. New procedures were implemented with the commercial banks, additional TA staff members were assigned, and the KPST placed staff at the TA to provide assistance. The results were positive. The reconciliation backlog has been eliminated and the timeline for reconciling new contributions has been significantly reduced. Work must continue on improving the processes in specific areas, such as contributions from the self-employed.

It is important to note the specifics of a transition or developing country tax administration. Unlike in a developed country where tax administration focuses on individual taxpayers and tax returns, in a developing/transition context tax priorities are on consumption taxes (VAT and excises) and profit taxes. Such tax administrations have little capacity or infrastructure for dealing with individuals. Therefore, the argument in favor of unification of tax and pension payments may be weaker than in developed countries, where tax administrations already have the skills necessary for pension collections.

IV.18.11 Reconciliation Timeline

The challenges with unified collection are expected to be short lived. The reconciliation backlog has been cleared and new contributions are being reconciled in timely fashion, procedures for exchange of data are being improved, and strong relationships are being fostered. The same is true for challenges relating to employer and banking sector capacity in the early stages. However, the issue of what will constitute timely reconciliation, once procedures are running smoothly, remains a topic for debate. See Section IV.10.3.

IV.18.12 Banking Sector Capacity

The banking sector in Kosovo is developing at a rapid rate. However, in the early stages of KPST operations, considerable challenges were experienced at the level of the commercial banks. The commercial banks are responsible for receiving payments from employers, consolidating daily payments into one transfer to the KPST account at the BPK, and sending employer declaration forms with a cover page for the daily transfer to the KPST account. During the initial two years of operation, a number of problems were regularly encountered such as: funds not transferred, documents not transferred, documents missing, double fund transfers, and split fund transfers. All of these issues made reconciliation impossible and required time consuming follow up with the banks. All documentation exchange between the banks and the TA was in paper format. Processes recently have been revised to streamline operations at the banks, and to begin the process of introducing electronic transfer of data. The improvements have been significant, and the reconciliation timeline is much improved.

IV.18.13 Employer Capacity

As would be expected anywhere a new pension system is being introduced, considerable time and effort has been committed to working with employers to help them learn to process contributions quickly and effectively. In particular, the KPST has had to work with employers extensively to ensure that the accurate ID numbers of all employees are provided.

A specific challenge in Kosovo, is the low rate of computer usage. Many employers do not own, or know how to use, a computer. As a result, the vast majority of quarterly reports and payrolls are provided to the TA in paper format. This necessitates contracting the Central Processing Centre to input the data on a quarterly basis, thereby increasing the timeline and introducing the risk of inputting error. The KPST has sought to reduce the impact of this challenge by encouraging large employers to report directly to the KPST, monthly, in electronic format. Currently, 400 employers report directly to the KPST, representing 49% of the total number of participants. The KPST is considering proposing a regulatory amendment that would require all employers to report directly to the KPST, on a monthly basis, by the end of 2007.

IV.18.14 Dealing with a Single Public Sector Employment Body

Initially, the prospect of having a single payroll unit, at the MPS, process contributions on behalf of all public sector employees seemed to be an enticing advantage. However, the resulting experience has not been completely positive. Complications were immediately encountered due to a number of issues, including: lack of capacity of the

MPS payroll IT system, lack of staff willing to support the pension payment process, use of an internal MPS payroll number, and lack of ability to process reporting corrections.

The lack of capacity in the MPS payroll IT system meant that the contribution reporting process required manipulation of extracted records outside of the main database. This impacted the quality of the initial reporting and significantly complicated the process of correcting report data. MPS has plans to develop a new, more advanced, electronic payroll system.

The MPS use of an internal payroll number, rather than the unique UNMIK ID, caused extensive delays in the reconciliation of contributions for MPS employees. KPST policy is that it will only reconcile contributions and open pension accounts for individuals who have provided either an UNMIK ID or an Individual Tax Number (the two numbering systems are jointly unique). As an employer, MPS was required by the pension regulation to obtain an UNMIK ID or ITN number for each employee. Initially the Payroll Unit failed to prioritize this task. The problem was compounded by the lack of enforcement mechanisms in the regions. Eventually, through a public education campaign, launched jointly by the KPST, TA and MPS, public sector employee ID numbers were largely secured. The KPST now has verified IDs for 98.9% of MPS employees.

IV.18.15 Account Statement Distribution

As discussed in Section IV.10.2, the KPST has tried three different means of distributing account statements to participants. The current approach involves mailing statements directly to the homes of participants, which was not possible in the early stages due to lack of mailing addresses and the poor quality of the postal system. Direct mailing has achieved the greatest level of success. In May 2006, only 4.7% of mailed statements were returned to the KPST by the postal agency. However, of 203,000 statements generated, only 193,000 were printed and mailed. In the remaining cases, the KPST had not been provided with a participant mailing address. Moving forward, the KPST will continue to distribute statements by mailing directly to participants. The challenge will be to continue to grow its database of mailing addresses through public efforts to inform participants of the need to provide this information.

V Pillar III

The Regulation on Pensions recognized that a number of pension arrangements had been established in Kosovo by individual enterprises in addition to the pensions provided by the state. These were occupational plans, established largely by state or socially owned enterprises. This included the telecom (PTK) and electricity (KEK) companies. However, in line with overall economic reform and the planned privatization of such assets, it was expected that the pensions of such enterprises would not receive any state support and would have to be sustained by employer contributions.

In the two years of UNMIK administration before the Pensions Regulation was promulgated, several such enterprises introduced unfunded and unsustainable early retirement pensions for redundant employees, as well as survivor pensions for the families of employees killed during the Kosovo conflict. While these arrangements were no doubt well motivated and in a number of instances were even approved by UNMIK administrators, they were not going to be sustainable in the future.

In addition, following the example of other post-socialist economies in transition, it was to be expected that purely voluntary individual arrangements, possibly through insurance companies, would be offered and should be regulated in order to prevent consumer fraud and encourage financial sector growth. Pillar III legislation was intended both to ensure fiscal balance in those pension funds created by SOEs, in order to avoid creating unforeseen contingent liabilities for the budget, and also more broadly to facilitate development of a rudimentary voluntary pension industry.

A large body of economic literature argues that financial markets (indeed all markets) function most efficiently without regulatory interference. This is not to say that markets are perfect; they are rife with failure. Regulatory intervention is appropriate to correct market failures. A regulatory regime must be limited and balanced and interfere just enough so as to correct market failure, and not interfere so much as to render the markets immobile and inefficient. Financial market failures, including in the pensions sector, occur for one or more of the following reasons, each of which requires specific solutions:

- Anti-competitive behavior
- Market misconduct
- Information asymmetry
- Systemic instability

The role of competition regulation is to assure that market participants do not circumvent market forces by fixing the price for a good, artificially reducing supply of a good, or selling to preferred customers at a lower price.[70] Market misconduct in the financial sector occurs when market participants engage in fraudulent conduct or inadequately disclose vital information. Market misconduct is addressed by requiring disclosure, introducing business rules for specific transactions, imposing standards for governance and fiduciary responsibilities, addressing conflicts of interest, and requiring minimum levels of financial strength for financial service providers. The third source of market failure, information asymmetry, arises where services or products are so complex that complete disclosure by itself is insufficient to permit consumers to make informed choices. This arises when buyers and sellers of products can never be equally informed, and is especially pertinent in the area of financial services such as pensions. The remedy for asymmetry of information is a regulatory regime interposed between the suppliers and the consumers to establish behavioral rules for the supplier and assure that promises made will be kept. Systemic instability arises when the failure of one institution leads to a general panic that can lead to the distress of otherwise sound institutions. The primary

[70] Carmichael, Jeffrey and Pomerleano, Michael, The Development and Regulation of Non-Bank Financial Institutions, The World Bank, 2002, chapter 2.

defense against such risk is a sustainable macroeconomic environment; the government must formulate a responsible monetary and fiscal policy. The regulator will also require a certain procedure and timing of payment transfers to prevent panic in the particular sector. In addition, the government may be a lender or administrator of last resort for failed institutions.

In choosing regulatory measures, the Kosovo Pensions Regulation focused on identifying the market failure to be addressed, and developing the least restrictive remedy necessary as a solution. Employer Pension Funds have large numbers of members who are not sophisticated in financial matters and unable to monitor how their funds are invested. This is particularly true if contributions are required. However, even in the case of voluntary contributions, the state must assure an adequate regulatory process. Special attention to the regulatory mechanisms is required to assure consumer protection of those who purchase supplementary individual pensions.

Licensing of private pensions is essential prior to marketing to the public and collecting contributions. Asset (or investment) managers who will invest, and custodians who hold assets, should also be licensed as participants in the capital markets, possibly under separate financial sector laws. Segregation of invested pension assets from all other assets under management and independent asset custody must be required.

A number of basic foundational documents must be required, in particular rules governing the relationship of the fund and the members, as well as procedures for internal governance and for appointing those who will invest assets. The regulatory authority may also issue model documents. Independent accounting and auditing must be required.

Chapters IV, V, VI, and VII of the Kosovo Pensions Regulation address all of these issues. The single financial sector regulator model was adopted in Kosovo, with the Banking and Payments Authority (BPK) regulating banks, insurance companies and pension funds. The BPK therefore licenses pension providers (both Employer Pension Funds and Supplementary Individual Pensions), investment managers and bank custodians.

Chapter IV, Section 14 of the Pensions Regulation provides that the BPK will license and regulate employer pension funds provided by employers and Chapter V, Section 21 provides that the BPK will regulate supplementary individual pensions provided by financial institutions banks and insurance companies.

The BPK must review the charters and bylaws of employer pension funds and review agreements with investment managers and custodians to be sure that these are licensed providers. The BPK has promulgated many Rules concerning specific issues, such as the contents of charters and bylaws.

Investment of pension assets must meet strict criteria, similar to those of the Kosovo Pension Savings Trust "to maximize returns on investment solely for the benefit of participants and beneficiaries." The goals of prudent investment for pension assets required by the Pensions Regulation are security of pension assets, diversity of investment, maximum return consistent with security, and adequate liquidity.

If defined benefit pensions are offered, the BPK will review actuarial calculations. Employer pension funds must report to the BPK and must also provide information to participants.

The BPK must license supplementary individual pensions as well. Supplementary individual pensions offered by financial services providers must meet investment, custody and reporting requirements.

The Pensions Regulation also establishes rules for terminating both employer pension funds and supplementary individual pensions.

In pre-conflict Kosovo there were no providers of supplementary individual pensions. However there were a number of employer pension funds, which provided promises of unsustainable benefits. The BPK has had the difficult task of identifying and regulating these entities, in some cases requiring their termination. The first stage was to identify these programs and to begin the process of formal separation of pension assets from employer assets. The BPK has addressed the need for actuarial calculations of defined benefit employer pension funds.

One could well argue that there were no existing Pillar III old age pensions in Kosovo. Those that were found by the BPK regulators when implementation began were more narrowly designed to pay pensions because of: retrenchments, death or disability of the employee, or even simply for social assistance. The BPK tried to legalize these schemes to: (1) establish standards and uniform pension eligibility rules, (2) limit the amount of pensions and paying periods (otherwise they were open-ended), (3) require adequate funding of pension obligations, and (4) require the segregation of pension funds from employer assets.

The regulatory challenge for the BPK is to maintain authority over such arrangements in spite of potential interference by other interests. For example, with respect to the mining complex in Trepca, efforts have been undertaken to provide what is in effect an early retirement pension at state expense outside the legal and financial requirements of the Pensions Regulation.

After a year of pension regulatory operations, there were only four pension funds licensed by the BPK: (1) KEK, (2) PTK, (3) BPK, and (4) Grand Hotel. All of these were defined benefit pensions with limited payment periods. The BPK insisted upon the adoption of realistic funding schedules.

There were other pension arrangements that sought licensing by the BPK, but could not comply with funding requirements and minimum funding schedules.

To date the regulation of pensions by the BPK has been supported by advisors and line management personnel from the IMF and USAID. The ultimate objective is to develop local capacity and to transfer authority to local counterparts.

VI Lessons Learned

To conclude this paper on the Kosovo pension reform experience, the following lessons learned are presented, regarding both policy and implementation.

VI.1 Policy Issues

- *Fiscal Sustainability.* The combination of a universal, PAYG pension, paid from general revenues rather than a wage tax, coupled with a sizable funded component, can successfully place a country on a path to long-term fiscal sustainability. Anchoring the universal pension to a real indicator, such as a poverty level, increases the likelihood that pension levels can be contained for the medium term, during which time a funded pillar can grow and fill a vacuum to provide participants with a main savings source. This presumes that the level of the non-contributory or 'social pension' continues to rise in line with the specified price index.

- *Labor-market distortions.* Coordinated attention across pensions, taxation, and other social programs is needed to meaningfully reduce the total labor burden. In Kosovo, labor taxes were kept low by funding Pillar I from general revenues rather than from a wage tax, by not instituting any other social payroll taxes, and by keeping personal income tax rates low. Slippage in any of these three areas would hurt labor-market efficiency.

- *Coverage and poverty alleviation.* One of the drawbacks of the old pension system was its low rate of coverage—reaching approximately half of the elderly over 65. The new flat benefit for all persons 65 years of age and older has proven an effective means of meeting the broader needs of Kosovo's old age population. The downside is that high-income earners and participants in the former system feel that they are being under-compensated. However, the upside is that the coverage extends to individuals who did not have the opportunity to work during the 1990s, to women who have worked in the home, and to workers in the agriculture sector. In addition, the program has been successful in providing benefits to minority individuals. Data show that Serbs make up a significantly higher proportion of basic pension recipients than their proportion of the population.

- *Investments abroad.* The Kosovo experience shows how a country with no capital markets can still introduce a modern funded pension system with all the safeguards found in North America or Western Europe. This was accomplished by investing pension assets abroad, at least initially, and also by using foreign professional expertise in making investment decisions. This was possible, to a large extent, because of the governance situation at the time this policy was implemented.

- *Administrative fees.* Administrative costs can be significant and should be considered at the reform design stage. Funded pillars should be designed so that they are large enough to achieve economies of scale, with cost-efficient administration. If this is not achievable, alternative reform designs should be chosen. In Kosovo this has been achieved through a single Pillar II pension provider with lean administrative systems. A decision was taken to charge an asset fee and no contribution fee. This reduces administrative costs to participants in the initial years, though it requires a start-up subsidy to help cover expenses until sizable assets accumulate.

- *Supervision.* Supervisory regimes of funded pensions require ongoing monitoring and training, to ensure that they are equipped to address issues that arise as pension systems and financial markets develop. Compared to many parastatal sole pension providers (such as provident funds), the KPST is innovative in that it is supervised by the national financial-sector regulatory body, in the same manner that private financial institutions are regulated, in addition to being subject to certain policy decisions of the executive branch.

- *Sequencing.* The most important lesson of sequencing is to seize a political window of opportunity when it opens, designing reforms in the context of the level of country development. Kosovo happened to have a window of opportunity in 2001 when political pressure to "do something" about pensions was mounting. Policymakers seized the opportunity and successfully implemented a bold, successful pension reform despite the lack of a financial market and limited governing capacity.

- *Public education.* Four years of experience have shown the importance of placing high priority on public education efforts during the implementation of a new mandatory pension system. In the post-conflict period, the Kosovar public had little confidence in financial institutions. There had been a history of loss of pension rights, and financial institution failures. The KPST approach was to identify the priority messages and to consistently repeat them in advertising, posters, billboards, media interviews, newspaper columns and public meetings. The approach appears to be paying dividends in that public awareness of the KPST and its role has increased. Many years of public education still lay ahead as the KPST seeks to continue to increase the understanding of the public and to gain trust.

- *Retirement age.* The issue of relative retirement ages for men and women is a hotly debated topic during pension reforms around the world. It is not uncommon for political leaders to oppose equal retirement ages. Indeed, the pension systems in all countries that formerly comprised Yugoslavia, with the exception of the province of Kosovo, have younger retirement ages for women. In Kosovo, the decision to proceed with one retirement age, regardless of sex, was not met with political resistance and implementation has been unopposed in this regard. This raises the question of whether this issue is exaggerated in its importance in other countries, or whether conditions in Kosovo paved the way for a uniform retirement age. One could argue that the decision was made easier by the fact that one half of Kosovars who are 65 years of age or older did not qualify for pension payments under the old system, and, as a result, they stood to lose nothing under the new system regardless of how it was structured.

- *Banking sector.* The implementation of the basic pension carried with it a secondary benefit of helping to expand the reach of the banking sector. The Kosovo Pension Administration determined that basic pension benefits would only be distributed electronically, via individual bank accounts. The concept of electronic transfers as a form of payment was relatively new to Kosovo in the immediate post-conflict period. To ease the transition, pensioners did not have to open accounts on their own. Rather, when they filled in the application for the basic benefit, the form allowed them to select a bank. By submitting the pension application to the Pension Administration, an account was automatically opened for them at their bank of choice. The policy resulted in cost efficient distribution of benefits for the pension administration, and an increase in the reach of the developing banking sector. More than 100,000 pensioners have registered to receive the basic pension via personal bank accounts.

- *Overall pension policy.* It is important to ensure that a pension policy unit is created to oversee all components of a multi-pillar pension system. The absence of such a unit in Kosovo has led to some degree of confusion relating to who is responsible for developing and shepherding legislative reform. In addition, pension proposals and early retirement schemes have been proposed in Kosovo that are not consistent with the long term, sustainable, three-pillar pension approach. A central pension policy unit would be best placed to address these concerns.

VI.2 Implementation Issues

- *Unified Collection.* Unified collection for pension contributions has been a trade-off between cost efficiencies and the challenges of gaining the commitment of the Tax Administration. The stresses and challenges discussed in this paper, in large part, would have been avoided if the TA had not also been in a startup phase. When the mandatory savings pension was introduced, the TA was not ready to take on the additional responsibility that came with the mandate to collect and reconcile pension contributions. Implementation would have been much more smooth and risk-reduced if the savings pension program had been introduced at a point when the TA was firmly established and exhibited the capacity to expand its role. Some countries might decide that unification of collection makes sense to take advantage of economies of scale and minimize administrative burden to contributing firms. Other countries might decide that the tax system overall should focus on indirect taxes such as VAT and excises, and not direct taxes such as personal income taxes, meaning that tax administrations might not otherwise need to develop much skill in collecting individual payments. In such cases, segregation of tax and pension contribution collection to two separate agencies might be more appropriate.

- *Record Keeping.* Along the same theme, introducing the savings pension system before the IT system had been developed complicated the process of developing operational procedures. Instead of developing firm business processes as the basis for the IT system development, the KPST was forced to develop business processes on an ongoing basis, while contributions were being received, and while the IT system was being programmed. From an IT perspective, this is one of the reasons why the development contract lasted 2.5 years, rather than six months. On both these first two implementation issues, there may have been a tradeoff between taking advantage of a political window of opportunity on the one hand, and also taking sufficient time to set up administrative systems before beginning collection on the other.

- *IT Procurement and Development.* The KPST had two options for securing an IT system: 1) purchase a pre-developed software and customize it; or, 2) hire a programming firm and develop the system specifically for KPST needs. The KPST opted for the second option. The challenge was that the business processes were not fully defined before the start of programming. This lack of clarity, coupled with problems with the software developers, led to an extended 2.5-year development process that has produced a system that is functional, but has limited capacity for expansion. In retrospect, the additional financial cost of purchasing a pre-developed software system may have better suited the needs of the KPST, particularly given the short timeframe for implementation of the program. This conclusion assumes that sufficient funding would have been made available.

- *Phased Implementation.* The savings pension program was introduced in two phases: 1) the public sector, POEs, SOEs and private enterprises with 500 or more employees; and, 2) all other employers, including the self-employed. Breaking the implementation into phases was critical to the success of the program introduction. As in other countries, collection and reconciliation involving small employers has been a challenge. However, the large employers (e.g., MPS) also have been challenging, due to reporting difficulties associated with the use of inadequate IT systems, and the need to collect individual information from large numbers of employees. In future, similar reforms, policy makers may wish to build upon this experience by further breaking down the implementation into phases, for example, by limiting the first phase to civil service employees before expanding the program.

- *Implementation Timeline.* The implementation of a new pension system is highly labor intensive and requires a significant amount of time. Policy makers should not underestimate the importance of allowing sufficient time for planning and implementation before system introduction. In the case of Kosovo, the pension reform was fast-tracked, resulting in a challenging, though successful, implementation. This timeline was dictated largely by the political window of opportunity that existed in 2001-2002.

Though not without its challenges, the Kosovo pension reform has succeeded in creating a system that provides adequate pensions, alleviates poverty, manages risks, and is fiscally sustainable and compatible with economic growth and development.

References

Anusic, Zoran. “Administrative Charges of Private Mandatory Pension Funds.” Presentation for ILO Tripartite Conference on “Recent Developments on Pension Restructuring in Central and Eastern Europe.” Budapest, December 2004. Some information in this presentation comes from Anton Dobronogov and Mamta Murthi, “Administrative Fees and Costs of Mandatory Private Pensions in Transition Economies,” JPEF, March 2005.

Carmichael, Jeffrey and Palacios, Robert. “A Framework for Public Pension Fund Management.” Paper presented to 2nd Public Pension Fund Management Conference. World Bank, Washington, DC, May 5-7, 2003.

Carmichael, Jeffrey and Pomerleano, Michael. The Development and Regulation of Non-Bank Financial Institutions. The World Bank, 2002.

Central Bank of Hungary. “The Sustainability of the Hungarian Pension System: A Reassessment,” Occasional Papers, No. 40, 2005.

Chlon-Dominczak. “Funded Pensions in Transition Economies in Europe and Central Asia: Design and Experience.” International Federation of Pension Funds Association (FIAP) and World Bank, 2003.

Chlon-Dominczak. “Polish Pension Reform: Basic Assumptions and Recent Developments.” Ministry of Labour and Social Policy, Warsaw, September 18, 2006.

Holzmann, Robert and Hinz, Richard. Old-Age Income Support in the Twenty-first Century: An International Perspective on Pension Systems and Reform. The World Bank, February 18, 2005.

International Monetary Fund. Aide Memoire, May 2005.

International Monetary Fund. “Kosovo – Gearing Policies Toward Growth & Development.”

International Monetary Fund. Republic of Poland: Selected Issues, “The Polish Pension Reforms after Six Years.” June 30, 2005.

International Organisation for Migration. “Demographic, social, economic situation and reproductive health in Kosovo following the 1999 conflict: Results of a household survey November 1999-February 2000.”

“Kosovo Demographic and Health Survey 2003, Preliminary Results.” Draft chapters, April 2004.

Law on Organisation and Operation of Pension Funds. Poland, August 28, 1997.

Ministry of Economy and Finance. "Monthly Macroeconomic Monitor, Kosovo." May 2003.

Ministry of Social Policy, Poland. "Analysis: Calculation of Pension Contributions Paid into ZUS and OFE during September 1999 – June 2004." Department of Economic Analyses and Forecasts, October, 2004. English-language summary provided by Dariusz Stanko.

Organisation for Economic Co-operation and Development. Pensions at a Glance – Public Policies across OECD Countries 2005 Edition.

Palacios , R. and A. Sluchynsky. "Social Pensions Part I: Their Role in the Overall Pension System." World Bank Pension Reform Primer, 2006.

Provisional Institutions of Self-Government, Ministry of Economy and Finance (Kosovo). "Medium Term Budget Framework, Budget Strategy 2006 – 2008." July, 2005.

Statistical Office of Kosovo. Regular CPI publication.

World Bank. Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth. Oxford University Press, London, 1994.

Direct Sources of Data

Kosovo Pension Savings Trust, Pristina, Kosovo.

Macro-Economic Unit, Ministry of Economy and Finance, Pristina, Kosovo.

Ministry of Labor and Social Welfare, Pristina, Kosovo.

Records of the Kosovo Social Insurance Fund (former pension system), Pristina, Kosovo.

Statistical Office of Kosovo, Pristina, Kosovo.

Web Sites

www.kpst.org
www.nato.int/kosovo/history.html
www.unmikonline.org

Appendix One: Draft of new KPST Account Statement

TRUSTI I KURSIMEVE PENSIONALE TË KOSOVËS
KOSOVO PENSION SAVINGS TRUST
TRUST KOSOVSKIH PENZIONIH ŠTEDNJI
rr.Zenel Salihu, nr.25,Prishtinë
(038) 244 368 / 244 337, info@kpst.org , www.kpst.org

MEMBER ACCOUNT STATEMENT

Ymer Salihu
rr.Agim Ramadani 12/A
39000 BABALLOQ-DEÇAN KOSOVË
0000000012 - 374 - 82305678 / 90000004

Employee Name	Employee ID	Report Period *
Ymer Salihu	1000481374	Q2-2004 -- Q4-2004

	Period	Transaction Description	Employer (E)	Employee (E)	Total (E)	Unit Price	Number of Units
Balance from last statement					40		38
	Q3 2003	Payment from Ministry of Public Services	5	5	10	1.1	9.09
	Q4 2003	Payment from Ministry of Public Services	5	5	10	1.2	8.33
	Q2 2004	Payment from Ministry of Public Services	5	5	10	1.3	7.69
Net Investment earnings **					24.67		
New Balance ***					94.67	1.5	63.11

* This includes all reconciled contributions for the quarters Q2-Q4, 2004 (plus earlier contributions, if reconciled during this report period). Does not include contributions that may have been made but have not been reconciled.
** Net Investment Earnings = Gross Investment Earnings – Management Fee. Net Investment Earnings are included in the changing unit price. Net investment earnings on this statement are since the last report period, which was up to Q1 2004.
*** New balance = balance from last statement + contributions – refunds – benefits paid + net investment earnings. The unit price used to calculate the balance is as of xxxx 2005.

Note: The KPST management fee for 2004 was 1% of assets.

Social Protection Discussion Paper Series Titles

No.	Title
0707	The Kosovo Pension Reform: Achievements and Lessons by John Gubbels, David Snelbecker, Lena Zezulin, April 2007 (online only)
0706	Measuring Disability Prevalence by Daniel Mont, March 2007
0705	Social Safety Nets in World Bank Lending and Analytic Work: FY2002-2006 compiled by Annamaria Milazzo and Margaret Grosh, March 2007 (online only)
0704	Child Labor and Youth Employment: Ethiopia Country Study by Lorenzo Guarcello and Furio Rosati, March 2007
0703	Aging and Demographic Change in European Societies: Main Trends and Alternative Policy Options by Rainer Muenz, March 2007 (online only)
0702	Seasonal Migration and Early Childhood Development by Karen Macours and Renos Vakis, March 2007
0701	The Social Assimilation of Immigrants by Domenico de Palo, Riccardo Faini and Alessandra Venturini, February 2007 (online only)
0616	Pension Systems in Latin America: Concepts and Measurements of Coverage by Rafael Rofman and Leonardo Lucchetti, November 2006 (online only)
0615	Labor Market Outcomes of Natives and Immigrants: Evidence from the ECHP by Franco Peracchi and Domenico Depalo, November 2006 (online only)
0614	The Relative Merits of Skilled and Unskilled Migration, Temporary and Permanent Labor Migration, and Portability of Social Security Benefits by Johannes Koettl under guidance of and with input from Robert Holzmann and Stefano Scarpetta, November 2006 (online only)
0613	The Limited Job Prospects of Displaced Workers: Evidence from Two Cities in China by Gordon Betcherman and Niels-Hugo Blunch, October 2006

0612 Unemployment Insurance in Chile: A New Model of Income Support for Unemployed Workers
by Germán Acevedo, Patricio Eskenazi and Carmen Pagés, October 2006

0611 Evaluating Social Fund Impact: A Toolkit for Task Teams and Social Fund Managers
by Sarah Adam, October 2006

0610 Risk and Vulnerability Considerations in Poverty Analysis: Recent Advances and Future Directions
by Carlo Cafiero and Renos Vakis, October 2006

0609 Comparing Individual Retirement Accounts in Asia: Singapore, Thailand, Hong Kong and PRC
by Yasue Pai, September 2006 (online only)

0608 Pension System Reforms
by Anita M. Schwarz, September 2006 (online only)

0607 Youth Labor Market in Burkina Faso: Recent Trends
by Daniel Parent, July 2006

0606 Youth in the Labor Market and the Transition from School to Work in Tanzania
by Florence Kondylis and Marco Manacorda, July 2006

0605 Redistributing Income to the Poor and the Rich: Public Transfers in Latin America and the Caribbean
by Kathy Lindert, Emmanuel Skoufias and Joseph Shapiro, August 2006 (online only)

0604 Uninsured Risk and Asset Protection: Can Conditional Cash Transfer Programs Serve as Safety Nets?
by Alain de Janvry, Elisabeth Sadoulet, Pantelis Solomon and Renos Vakis, June 2006

0603 Examining Conditional Cash Transfer Programs: A Role for Increased Social Inclusion?
by Bénédicte de la Brière and Laura B. Rawlings, June 2006 (online only)

0602 Civil-service Pension Schemes Around the World
by Robert Palacios and Edward Whitehouse, May 2006 (online only)

0601 Social Pensions Part I: Their Role in the Overall Pension System
by Robert Palacios and Oleksiy Sluchynsky, May 2006 (online only)

0543 Complementing Natural Disasters Management: The Role of Social Protection
by Renos Vakis, February 2006

0542 Brazil's Bolsa Escola Program: The Role of Local Governance in Decentralized Implementation
by Alain de Janvry, Frederico Finan, Elisabeth Sadoulet, Donald Nelson, Kathy Lindert, Bénédicte de la Brière and Peter Lanjouw, December 2005 (online only)

0541 Japan's Pension Reform
by Junichi Sakamoto, December 2005 (online only)

0540 Demographic Alternatives for Aging Industrial Countries: Increased Total Fertility Rate, Labor Force Participation, or Immigration
by Robert Holzmann, December 2005 (online only)

0539 Disability, Poverty and Schooling in Developing Countries: Results from 11 Household Surveys
by Deon Filmer, November 2005 (online only)

0538 Food Aid and Food Security in the Short- and Long Run: Country Experience from Asia and sub-Saharan Africa
by Carlo del Ninno, Paul A. Dorosh and Kalanidhi Subbarao, November 2005 (online only)

0537 The New Pensions in Kazakhstan: Challenges in Making the Transition
by Richard P. Hinz, Asta Zviniene and Anna-Marie Vilamovska
September 2005 (online only)

0536 Household's Vulnerability to Shocks in Zambia
by Carlo del Ninno and Alessandra Marini, September 2005 (online only)

0535 Linking Community Empowerment, Decentralized Governance, and Public Service Provision through a Local Development Framework
by Louis Helling, Rodrigo Serrano, David Warren, September 2005 (online only)

0534 Youth Employment in the MENA Region: A Situational Assessment
by Nader Kabbani and Ekta Kothari, September 2005

0533 Measuring Risk Perceptions: Why and How
by Joachim De Weerdt, July 2005

0532 Implementing Means-Tested Welfare Systems in the United States
by Kathy Lindert, June 2005 (online only)

0531 La Focalización En El Programa De Desarrollo Humano Oportunidades De Mexico
by Mónica Orozco y Cecilia Hubert, June 2005 (online only)

0530 Sistema de Identificación de la Población Objetivo: SIPO en Costa Rica
by Roxana M. Víquez, June 2005 (online only)

0529 Targeting Social Spending To the Poor with Proxy–Means Testing: Colombia's SISBEN System
by Tarsicio Castañeda, June 2005 (online only)

0528 Focalización De Programas En Chile: El Sistema CAS
by Osvaldo Larrañaga, June 2005 (online only)

0527 Reforming Brazil's Cadastro Único to Improve the Targeting of the Bolsa Família Program
by Bénédicte de la Brière and Kathy Lindert, June 2005 (online only)

0526 Designing and Implementing Household Targeting Systems: Lessons from Latin American and The United States
by Tarsicio Castañeda and Kathy Lindert, with Bénédicte de la Brière, Luisa Fernandez, Celia Hubert, Osvaldo Larrañaga, Mónica Orozco and Roxana Viquez, June 2005 (online only). Also available in Portuguese.

0525 Unequal Prospects: Disparities in the Quantity and Quality of Labour Supply in sub-Saharan Africa
by John Sender, Christopher Cramer and Carlos Oya, June 2005

0524 Pension Supervision: Understanding International Practice and Country Context
by Richard P. Hinz and Anca Mataoanu, May 2005

0523 Social Security Coverage in Latin America
by Rafael Rofman, May 2005

0522 A Technology White Paper on Improving the Efficiency of Social Safety Net Program Delivery in Low Income Countries: An Introduction to Available and Emerging Mobile Technologies
by Mike Gallaher, May 2005 (online only)

0521 Aging and Poverty in Africa and the Role of Social Pensions
by Nanak Kakwani and Kalanidhi Subbarao, May 2005 (online only)

0520 Delivery Mechanisms of Cash Transfer Programs to the Poor in Bangladesh
by Shaikh S. Ahmed, May 2005 (online only)

0519 Portability Regimes of Pension and Health Care Benefits for International Migrants: An Analysis of Issues and Good Practices
by Robert Holzmann, Johannes Koettl and Taras Chernetsky, May 2005 (online only)

0518 Who Has the Yam, and Who Has the Knife? Social Action Funds and Decentralization in Malawi, Tanzania, and Uganda
by N. Mungai Lenneiye, May 2005

0517 Household Vulnerability and Children's Activities: Information Needed from Household Surveys to Measure their Relationship
by Diane Steele, May 2005 (online only)

0516 The Effect of Child Labor on Mathematics and Language Achievement in Latin America
by Mario A. Sanchez, Peter F. Orazem, and Victoria Gunnarsso, May 2005

0515 The Inter-Generational Persistence of Child Labor
by Patrick M. Emerson and André Portela Souza, May 2005

0514 How Does Working as a Child affect Wage, Income and Poverty as an Adult?
by Nadeem Ilahi, Peter F. Orazem, and Guilherme Sedlacek, May 2005

0513 Dynamics of Child Labor: Labor Force Entry and Exit in Urban Brazil
by Suzanne Duryea, Jasper Hoek, David Lam and Deborah Levison, May 2005

0512 The Responses of Child Labor, School Enrollment, and Grade Repetition to the Loss of Parental Earnings in Brazil, 1982-1999
by Marcelo Côrtes Neri, Emily Gustafsson-Wright, Guilherme Sedlacek and Peter F. Orazem, May 2005

0511 Child Labor, Schooling, and Poverty in Latin America
by Guilherme Sedlacek, Suzanne Duryea, Nadeem Ilahi, and Masaru Sasaki, May 2005

0510 Changing Patterns of Child Labor around the World since 1950: The Roles of Income Growth, Parental Literacy and Agriculture
by Victoria Gunnarsson, Peter F. Orazem, and Guilherme Sedlacek, May 2005

0509 Disability and Social Safety Nets in Developing Countries
by Sophie Mitra, May 2005

0508 Social Funds: A Review of Public Sector Management and Institutional Issues
by Mukhmeet Bhatia, May 2005

0507 Pension Reform in El Salvador
by Rodrigo Acuña, April 2005

0506 How Changes in Benefits Entitlement Affect Job- Finding: Lessons from the Slovenian "Experiment"
by Jan van Ours and Milan Vodopivec, April 2005

0505 A Guide to Multisector Labor Market Models
by Gary S. Fields, April 2005

0504 Multinational Enterprises and Training Revisited: Do International Standards Matter?
by Niels-Hugo Blunch and Paula Castro, March 2005

0503 Community-Based Health Insurance & Social Protection Policy
by Steven Tabor, March 2005 (online only)

0502 Towards a Better Understanding of the Nature, Causes and Consequences of Youth Labor Market Disadvantage: Evidence for South-East Europe
by Alexandre Kolev and Catherine Saget, March 2005 (online only)

0501 A Lecture on the Political Economy of Targeted Safety Nets
by Lant Pritchett, January 2005

0420 Can Conditional Cash Transfer Programs Improve Social Risk Management? Lessons for Education and Child Labor Outcomes
by Elisabeth Sadoulet, Frederico Finan, Alain de Janvry and Renos Vakis, December 2004

0419 Measuring Welfare for Small but Vulnerable Groups. Poverty and Disability in Uganda
by Johannes G. Hoogeveen, September 2004

0418 Institutional Analysis Toolkit for Safety Net Interventions
by Inke Mathauer, August 2004

0417 Trade Union Participation in the PRSP Process
by Lawrence Egulu, August 2004

0416 A New Approach to Social Assistance: Latin America's Experience with Conditional Cash Transfer Programs
by Laura B. Rawlings, August 2004

0415 Shocks and Coffee: Lessons from Nicaragua
by Renos Vakis, Diana Kruger and Andrew D. Mason, July 2004

0414 Costs of Projects for Orphans and other Vulnerable Children: Case studies in Eritrea and Benin
by Menahem Prywes, Diane Coury, Gebremeskel Fesseha, Gilberte Hounsounou, and Anne Kielland, July 2004

0413 Disability Employment Policy
by Daniel Mont, July 2004

0412 Child Labor, Education, and Children's Rights
by Gordon Betcherman, Jean Fares, Amy Luinstra, and Robert Prouty, July 2004

0411 Challenges and Opportunities of International Migration for the EU, Its Member States, Neighboring Countries and Regions: A Policy Note
by Robert Holzmann and Rainer Münz, June 2004

0410 Evaluating Different Approaches to Estimating Vulnerability
by Ethan Ligon and Laura Schechter, June 2004

0409 Transferring Cash Benefits Through the Banking Sector in Colombia
by Maria Teresa Lafaurie V. and Claudia A. Velasquez Leiva, May 2004

0408 Mitigating Social Risks in Kyrgyz Republic
by Emil Tesliuc, April 2004

0407 Toward a Reformed and Coordinated Pension System in Europe: Rationale and Potential Structure
by Robert Holzmann, April, 2004

0406 Boosting Productivity Via Innovation and Adoption of New Technologies: Any Role for Labor Market Institutions?
by Stefano Scarpetta and Thierry Tressel, March 2004

0405 Mitigating the Social Impact of Privatization and Enterprise Restructuring
by David H. Fretwell, March 2004

0404 Risk and Vulnerability in Guatemala: A Quantitative and Qualitative Assessment
by Emil D. Tesliuc and Kathy Lindert, March 2004

0403 Implicit Pension Debt: Issues, Measurement and Scope in International Perspective
by Robert Holzmann, Robert Palacios and Asta Zviniene, March 2004

0402 Impacts of Active Labor Market Programs: New Evidence from Evaluations with Particular Attention to Developing and Transition Countries
by Gordon Betcherman, Karina Olivas and Amit Dar, January 2004

0401 Consumption Insurance and Vulnerability to Poverty: A Synthesis of the Evidence from Bangladesh, Ethiopia, Mali, Mexico and Russia
by Emmanuel Skoufias and Agnes R. Quisumbing, January 2004

To view Social Protection Discussion papers published prior to 2004, please visit www.worldbank.org/sp.

This paper tells the story of the Kosovo reform and draws policy and implementation lessons from the experience. The paper discusses policy issues and implementation experience in great detail, to serve as a resource for others interested in various aspects of the Kosovo reform. Readers who want to understand an overview of the reform and key lessons drawn from the experience may wish to turn immediately to: Section II.2, which presents an overview of the three pillars; Sections III.7 and IV.18, which present the specific challenges confronted in implementing Pillars I and II, respectively; and Section VI, which summarizes the lessons learned about policy and implementation issues from the Kosovo reform experience.

HUMAN DEVELOPMENT NETWORK