

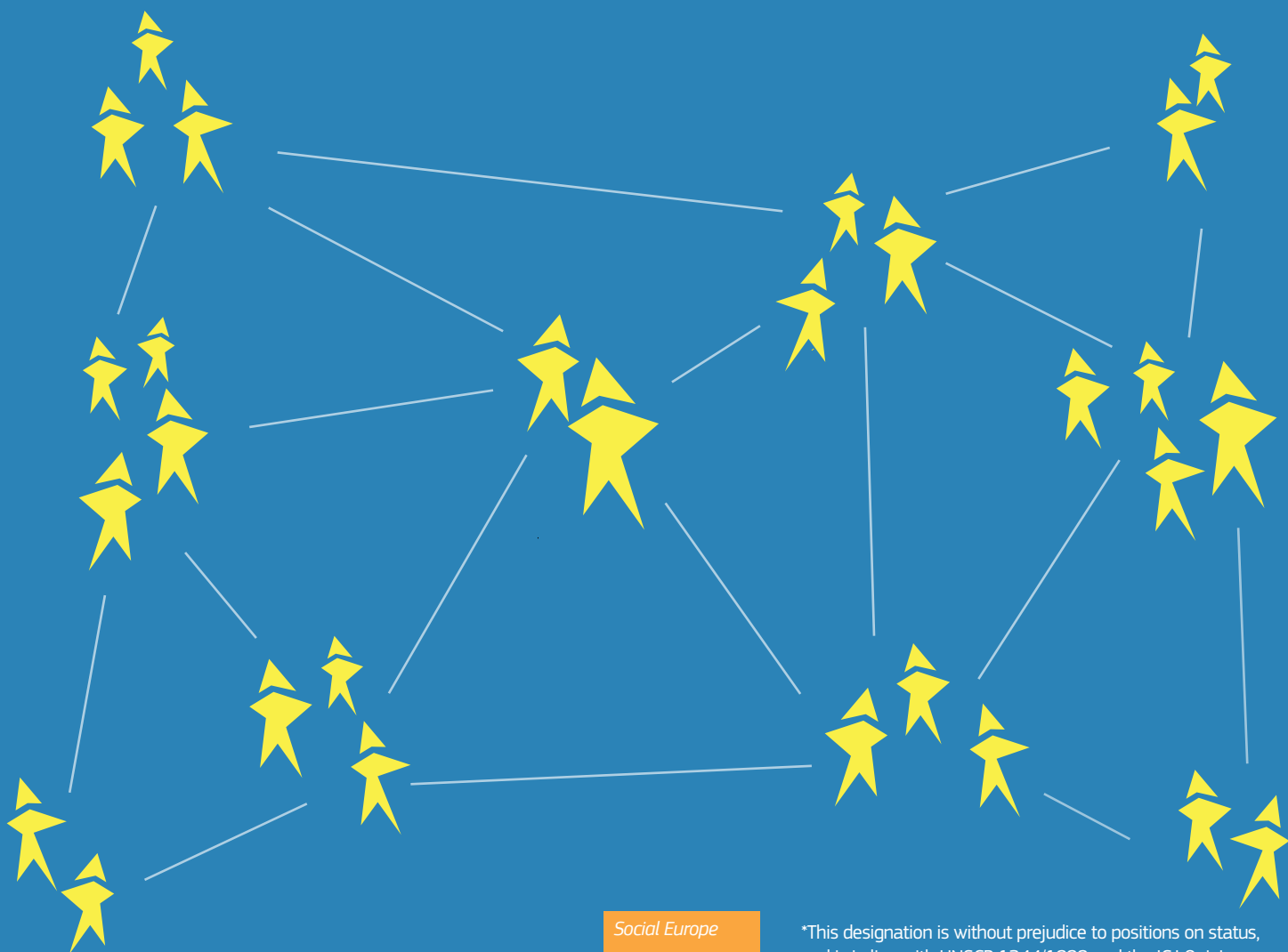


EUROPEAN SOCIAL POLICY NETWORK (ESPN)

# Financing social protection

## Kosovo\*

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*Social Europe*

\*This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

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**European Social Policy Network (ESPN)**

**ESPN Thematic Report on  
Financing social protection**

**Kosovo**

**2019**

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# Contents

SUMMARY ..... 6

1 CURRENT LEVELS AND PAST CHANGES IN FINANCING SOCIAL PROTECTION ..... 8

2 CURRENT MIX AND PAST CHANGES IN THE SOURCES OF FINANCING SOCIAL PROTECTION ..... 13

3 STRENGTHS AND WEAKNESSES OF THE EXISTING MIX OF FINANCING OPTIONS AND POTENTIAL FUTURE SOURCES OF FINANCING - NATIONAL DEBATE ON THE TOPIC..... 16

REFERENCES ..... 20

## Summary

**Kosovo's social protection expenditure is growing, but it remains fairly low in comparison to European and regional levels.** The total expenditure grew by 4 percentage points from 2005 to 2016, but it still remained at below 9% (8.9% in 2016) of gross domestic product (GDP). Kosovo's expenditure is almost entirely financed by government revenues, and this structure is not likely to change significantly in the foreseeable future. A small share of expenditure is financed by mandatory pension savings, private health insurance, user fees, other out-of-pocket payments for healthcare, and international donations.

**Expenditure growth is caused by important institutional changes introduced after Kosovo's declaration of independence.** When the United Nations Mission in Kosovo (UNMIK), in consultation with other international organisations (in particular the World Bank), launched the post-war (1999) institutions, it aimed to create a basic social floor financed through government revenues, involving: modest social services, a highly targeted social assistance programme, highly targeted allowances for invalids and victims of war, a flat-rate small universal pension for old age and a similar one for individuals permanently disabled. The rest of social protection was expected to be provided by the market, including in the form of mandatory pension savings, private health insurance, etc. Following the declaration of independence in 2008, several social benefits financed from general revenues were added to cover politically powerful social groups – such as veterans of the former Kosovo Liberation Army (KLA), former Albanian political prisoners of Yugoslavia, and former workers under Yugoslav so-called 'self-management socialism'; this created a growth in expenditure and brought about a major transformation in the overall goals of the social protection system.

**Kosovo does not have typical social insurance institutions, although interest in insurance is rising.** The legacy of former Yugoslav socialism favoured insurance institutions financed by employers and employees; hence there was some expectation that social protection in Kosovo would develop in the insurance direction, as the country's economy grew. With the support of the World Bank, a law introducing social health insurance was adopted in 2014; however, its implementation has not yet commenced. Meanwhile, no other insurance institution has been created to provide protection for typical social risks, such as unemployment, disability at work, sick leave, etc. The local interest in insurance has recently been rising – left-leaning political parties are pushing for a pay-as-you-go (PAYG) pension and various other insurance programmes. Their actions could lead to relevant reforms, adding to finance sources for social protection.

**The current financing structure does not help social protection to effectively moderate poverty and inequality.** Progressivity in personal income tax is low and the entire revenue collected from direct taxation amounts to around 14% of total government revenue. Most revenues are collected through consumption taxation, where the poor normally contribute relatively more than the rest of society. The largest share of revenue goes on public-sector wages and services, as well as on social protection expenditure, which is increasingly covering powerful categories rather than persons and individuals in need or poverty. This structure of finances – in addition to such other factors as a weak connection between those social transfers that are intended to reach the poorest and people's living conditions or income – creates a low and declining effectiveness of social protection in reducing poverty and inequality.

**Unemployment remains extensive.** The official unemployment rate averages 30%, although international surveys (Siddiqui et al., 2018) suggest that the unemployment rate is nearly 14 percentage points lower, largely due to high informality. High unemployment requires careful consideration. Any social protection reform should carefully balance labour costs with social protection needs. However, Kosovo's past two decades also indicate that perhaps a greater government presence (through labour activation and quality social insurance) could help reduce unemployment and make formal labour rationally attractive. Direct taxation could further help in the better

distribution of job resources, as many jobs are concentrated around politically powerful individuals and clans.

## 1 Current levels and past changes in financing social protection

### **Kosovo's overall social protection expenditure is the absolute lowest in Europe.**

Expressed in current prices, Kosovo's expenditure relative to GDP ranged between 5.9% (2005) and 8.9% (2016), as Table 1 below shows. Despite increases over recent years, in particular after 2013, its total social protection expenditure remained the lowest on the continent, according to indicators for other countries provided by the European System of Integrated Social Protection Statistics (ESSPROS) for the period 2005-2016. These indicators do not include Northern Macedonia, Albania and Montenegro, but according to the World Bank (2016) data, total expenditure in the three countries is higher than Kosovo's. The overall low expenditure, in addition to the design or structure of institutions, is one of the main reasons behind the extensive poverty and inequality, and the poor effectiveness of social protection in addressing and reducing poverty and inequality in Kosovo (see ESPN, 2019).

**Most of the expenditure is financed through government revenues.** This happens because Kosovo does not have typical social insurance institutions, which elsewhere often ensure a significant mix in the financing structure of social protection. In the absence of insurance contributions, almost the entire expenditure is financed through general taxation (government revenues); a small share is financed by pension savings. The government revenues are themselves generally (up to 85% in 2018) collected through consumption taxation, such as value added tax (VAT), excise on various imports, and fees on government and municipal services. This means that the whole of society finances social protection – with the poor contributing relatively more than the others (since they spend most of their income on living costs, whereas the better-off can save and invest); meanwhile redistribution is low.

**Table1: Share of total gross expenditure (2005-2016) on social protection relative to (%) GDP and in EUR million, according to the source**

Year	Total expenditure				Government revenue		Private expenditure	
	GDP	EUR Mil.	GDP <sup>1</sup>	EUR Mil.	GDP	EUR Mil.	GDP	EUR Mil.
2005	5.9	177.3	5.8	230.0	5.9	176.9	0.0	0.3
2006	5.8	178.6	5.6	231.6	5.7	178.6	0.0	1.1
2007	5.2	178.9	5.0	220.8	5.1	177.2	0.0	1.6
2008	5.5	211.7	5.1	238.9	5.3	206.3	0.1	5.3
2009	5.9	240.1	5.8	277.9	5.7	233.3	0.2	6.7
2010	5.9	257.8	5.8	288.3	5.7	250.3	0.2	7.4
2011	5.9	283.8	5.7	295.6	5.7	272.5	0.2	11.3
2012	6.2	314.0	6.0	319.1	5.9	299.3	0.3	14.7
2013	6.8	360.8	6.5	360.5	6.5	347.1	0.3	13.6
2014	7.6	420.6	7.5	418.5	7.2	401.8	0.3	18.8
2015	7.9	461.2	7.9	461.2	7.6	440.2	0.4	21.0
2016	8.9	540.2	8.9	538.6	8.5	515.0	0.4	25.1

Notes: GDP = GDP on current prices; GDP<sup>1</sup> = Constant prices, 2015 = 100; Government revenue = Expenditure financed through general government revenues; Private expenditure = Kosovo Pensions Savings Trust (KPST) expenditure in payments of mandatory pension savings and its administration.

Source: Own calculations. Source base: GDP in current and constant prices (IMF, 2018), Government revenue and private expenditure (Official Gazette of the Republic of Kosovo, 2016; KPST, 2012, 2016; and data issued by the Ministry of Labour and Social Welfare (MLSW)).



**The largest share of expenditure on social protection goes on pensions for old-age citizens.** Expenditure on old-age pensions amounts to about 3.5% of GDP. Most of this expenditure, up to 92.5%, goes on government-financed pension programmes for old age. These programmes are: (1) a basic flat-rate pension issued universally to all resident citizens over the age of 65, whatever their work history, which commenced in 2002; and (2) a pension (which commenced in 2008) for retiring former workers under self-management socialism (1952-1989) who contributed to the former Yugoslav PAYG pension arrangements. Since Yugoslav PAYG pensions were cancelled entirely by the United Nations Mission in Kosovo after the war (1999), Kosovo institutions had to move to accommodate the requests of former workers for a better pension income than that provided through basic pensions. The number of beneficiaries in this scheme will continue to grow over the next decade.

**The role of mandatory pension saving payments for old age is minor, despite some growth in recent years.** Kosovo launched mandatory Pillar II pension savings in 2002. The savings are financed equally by employers and employees, each paying a minimum 5% of gross wages. Savings are managed by the Kosovo Pension Savings Trust (KPST), an autonomous body whose board (usually involving international experts, as well as local ones) is elected by Parliament. The KPST invests most of the savings in western financial markets and a smaller share in government bonds. When they reach the age of 65, the individual workers get back their invested spending as a monthly payment, based on a personal agreement with the KPST. Such pension saving income paid by the KPST should grow in the long-term future, but until 2016, the maximum annual total payment was less than EUR 20 million (Table 2). These pension savings are not social insurance pension programmes and do not involve the traditional solidarity of the PAYG pensions. Pillar III voluntary personal pensions are almost irrelevant, with a 0.6% share of existing Kosovar pension saving assets (see ESPN, 2018).

**Table 2: Receipts of social protection in EUR and as % financing, 2005-2016**

Year	Total receipts	Government revenue		KPST financing	
	EUR Mil.	EUR Mil.	% of total receipts	EUR Mil.	% of total receipts
2005	<b>177.3</b>	176.9	99.8	0.0	0.4
2008	<b>211.7</b>	208.5	98.5	0.1	3.4
2010	<b>257.8</b>	252.8	98.0	0.1	5.0
2015	<b>450.7</b>	431.4	95.7	0.3	19.3
2016	<b>529.7</b>	510.5	96.4	0.3	19.2

Source: Own calculations. Government revenue (Official Gazette of the Republic of Kosovo, 2016 and data issued by MLSW), KPST financing by employers and employees each at 50% (KPST, 2012, 2016).

**Other existing pensions, including the disability pension, are all financed from government revenues.** These pensions include pensions for individuals with permanent work disability, pensions for blind individuals, early-retirement pensions for a few thousand former workers of the 'Trepça' mine, as well as for former members of the Kosovo Protection Corps and members of the Kosovo Security Force. In total, they amount to around 14% of all expenditure on government revenue-financed pensions.

**Table 3: Detailed breakdown of social protection expenditure, % GDP and EUR million, 2005-2016**

Year	2005		2008		2010		2015		2016	
Indicator	% of GDP	m EUR	% of GDP	m EUR	% of GDP	m EUR	% of GDP	m EUR	% of GDP	m EUR
<b>All social benefits</b>	<b>5.8</b>	<b>172.9</b>	<b>5.2</b>	<b>203.8</b>	<b>5.7</b>	<b>251.6</b>	<b>7.8</b>	<b>452.3</b>	<b>8.7</b>	<b>528.2</b>
Healthcare	1.7	52.2	1.5	57.9	1.6	70.8	2.1	120.2	2.2	131.3
Old Age	2.0	59.5	2.1	80.1	2.3	99.6	3.6	208.0	3.7	223.5
Disability	0.5	15.5	0.3	10.0	0.3	11.4	0.4	23.9	0.4	24.1
Family	0.0	0.4	0.0	0.7	0.1	4.1	0.1	4.8	0.1	4.7
Means-tested	1.0	31.1	0.7	26.1	0.6	28.6	0.4	25.3	0.5	28.8
Other exclusion	0.2	5.0	0.5	17.9	0.5	23.5	0.9	53.6	1.6	95.7
Trepça, KPC, KSF	0.0	2.6	0.0	2.8	0.0	3.4	0.1	7.5	0.1	7.7
Social services	0.2	6.7	0.2	8.3	0.2	10.2	0.2	9.0	0.2	12.6
Administration	0.1	4.5	0.2	8.0	0.1	6.2	0.2	9.0	0.2	12.0

Notes: Old age = Old age pensions paid by the state and private mandatory savings at KPST; Disability = Pensions for permanent disability from work and blind persons; Family = Benefits for children with disability, orphaned and abandoned children, as well as maternity leave; Means-tested = Social Assistance; Other social exclusion = Includes all expenditure on invalids of war, families of victims, veterans and former political prisoners; Trepça, KPC, KSF = Cash benefits for former miners of 'Trepça', for members of Kosovo Protection Corps, and pensions for members of Kosovo Security Forces.

Administration: costs of MLSW and KPST for administering social benefits.

Source: Own calculations. Source base: KPST (2012, 2016), Official Gazette of the Republic of Kosovo (2016), and data issued by MLSW.

### **Most recorded healthcare expenditure is similarly financed from general taxes.**

Most recorded healthcare expenditure is financed through government revenues; this amounted to 1.7% of GDP in 2005 and 2.2% of GDP in 2016 (see Table 3). It primarily goes on the wages of medical staff and the expenses of public hospitals, but it also includes financing of the essential list of drugs that are provided free to patients at service points, and various other medical services, such as services at detention centres.

Based on Kosovo Agency of Statistics data (KAS, 2016a), the share of voluntary private health insurance in the market is very small, amounting to EUR 16.2 million in total in 2016, although there has been a growing trend in recent years. According to a recent survey (Farnsworth et al., 2016) only 6% of Kosovars have private health insurance. Meanwhile, as the World Bank (2014:79) emphasises, private out-of-pocket payments for health services (including user fees) and drugs are much more significant, and could amount to 40% of healthcare expenditure. In addition, international donor resources in the health sector in Kosovo remained significant during the reporting period (e.g. 0.7% of GDP in 2005).

**Expenditure on the means-tested social assistance programme has steadily declined.** The decline has occurred, among other reasons, because the number of beneficiaries in the social assistance scheme has dropped by nearly 50,000 family members since independence (2008). This is primarily a consequence of tough eligibility criteria and weak poverty monitoring on the ground by the Centres of Social Work (CSW). In order for a family to become eligible for social assistance benefit – which should, by law, cover 2,100 calories of food per day for an equivalised family – all members of a family need to be dependent due to old age or serious illness, or a single parent who is able to work should have at least one child under five years of age. Since independence, the eligibility criteria have been tightened: any child reaching the age of 18 is now considered a member of the family capable of work – even if he/she attends

school (making previously eligible single-parent families ineligible) – and CSWs have to evaluate the property and livestock owned by families, using a detailed point-scoring system; this means that many poor families lose out on benefits because their score is just not low enough. In addition, rather than actively monitor poverty, CSWs react to applications, which leads to under-coverage, especially in rural areas due to a lack of information. Lastly, although the law links social assistance payments to the price of a minimal basket of food, the government has proved passive in reacting to changing market realities: only twice in the period under consideration (2005-2016) did it increase social assistance payment amounts.

**In recent years, expenditure on 'categories of war' and former political prisoners has increased most significantly.** The scheme for 'categories of war', as it is known locally, is the oldest government-financed scheme. It was created in 2001 by UNMIK to offer benefits to invalids of war and the next of kin of the dead. Back then, the eligibility criteria were tougher and the payments lower. Since independence, the key parties forming governing coalitions have been parties created from former political prisoners of self-management socialism and former leaders of the Kosovo Liberation Army (KLA). These parties eased the eligibility criteria for benefits specifically targeted at former KLA war invalids and the families of KLA members killed in the war; such benefits involve considerably higher payments than similar benefits for civilian victims of war. In addition, a scheme was created to issue lump-sum compensation for every day a former Albanian political prisoner of Yugoslavia spent in jail; and another scheme instituted a monthly payment for veterans of the KLA. The implementation of both schemes began in 2015. As Table 3 shows, in recent years this category of expenditure (referred to as "other social exclusion" in the table) has grown and requires most cash transfers (after pensions).

**Expenditure on family benefits is low.** These include transfers to families with children with permanent disabilities, transfers to families for accommodating orphaned or abandoned children, and maternity leave. The first two schemes are small and highly targeted. Maternity-leave compensation began in 2006 – the leave is paid for by employers for the first six months at 70% of the wage, and then the government contributes 50% of the wage for an additional three months. There is no universal or other scheme of allowances for children.

**There is an unsustainable financing formula in place for the generally underdeveloped social services.** Kosovo's institutions and politicians have been significantly less interested in social service developments than in cash transfers, and the decentralisation of power has not so far helped improve services. Social services are generally provided by municipal Centres for Social Work and the third sector; although, by law, CSWs are expected to cover a wide array of services, in practice they offer primarily care and advice in cases of violence in family, and monitoring of cases of orphaned and abandoned children placed within the community (families). The CSWs cooperate with – and delegate other service responsibilities, such as care for the ill and the disabled, to – licensed non-governmental organisations (NGOs). Extensive decentralisation of power from the central to the local level took place in 2009, but since then the number of CSW social workers has not increased significantly and the overall financing of services has become unsustainable. Services are financed through national pilot projects for municipalities and the municipalities' own funds. However, this has proved problematic for many municipalities, particularly small ones, which could not allocate budgets for services at all – especially for services that used to be subcontracted to NGOs. According to the Ministry of Labour and Social Welfare (2018), there are several municipalities where certain social services and NGO services are entirely absent. The overall expenditure on such services remained under EUR 5 million in 2016.

**Protected citizens do not pay tax on the transfers they receive.** Employers pay no tax on the pension savings they pay into the KPST; and protected citizens did not pay any tax on the pensions they received or on any other general tax-financed benefit during 2005-2016.

**There is no unemployment protection programme.** Kosovo does not have a typical unemployment protection programme. Existing expenditure on employment services (around EUR 5 million in 2016) focuses on jobseeker registration, professional training and administration.

**Administration costs for mandatory pension savings are almost equal to the entire administration costs of the Ministry of Work and Social Welfare (MLSW).** The Kosovo Pension Savings Trust reported administrative costs of EUR 5.99 million (KPST, 2016). These include fees charged on contributors' savings for asset investment and operational costs. Although the KPST's annual payment of old-age pensions amounts to less than 5% of total social benefits, its administrative costs in 2016 were almost equal to the entire administrative costs of the MLSW, which implements the bulk of social protection. Expenditure on MLSW's administrative costs during the same year was EUR 6.1 million.

**Calculations based on ESSPROS definitions.** The calculations presented in the tables and paragraphs above are based on the referenced administrative source data used according to the definitions of expenditures and receipts contained in ESSPROS (2016). Any omission should not be extensive. Since the credibility of national surveys is occasionally placed in question, administrative data such as those on social protection expenditure have the advantage of providing highly accurate information.

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

**Kosovo remains a rare example in Europe in that it does not use employer and employee insurance institutions and almost entirely finances social protection through government revenues.** Several international organisations' documents reveal that after the end of the conflict in 1999, there was a push for liberal social policy in Kosovo, but also there were discussions about the possible development of social insurance institutions in the country (World Bank, 2001:90). There was also an expectation that former workers would push forward these reforms. Yet, following the declaration of independence in 2008, most active changes took place in the form of 'layering' in tax-financed institutions, as politicians utilised easy, piecemeal solutions in exchange for electoral support. The existing structure will continue to shape expenditure outcomes for the coming decades. Although increasing pension saving payments will be issued by the KPST, its entire assets by 2019 were under EUR 1.7 billion, the employment rate was low at 29.1% and the unemployment rate high at 30.7% (KAS, 2018).

**The original design of social protection after the war pursued other aims.** Kosovo's post-war social protection was heavily impacted by international organisations (see e.g. Deacon and Stubbs, 2007; Cocozzelli 2007, 2009); in particular, the World Bank played a highly influential role in designing social protection institutions by advising UNMIK. Social protection had taken shape by the end of 2002. It consisted of the following: a) some basic social services implemented by the state administration and NGOs or the third sector; b) small cash allowances for invalids of war and the next of kin of the war dead; c) highly targeted, means-tested social assistance for poor families; d) universal basic pensions. The last two cash transfers were connected to the cost of a minimum basket of food. The World Bank described the aims of the connection: *'Because the basic pension is tied to the cost of the food basket ... the cost of the basic pension system is likely to increase at a rate lower than the overall growth rate of the economy, thus maintaining fiscal sustainability in the long run'* (World Bank, 2005: 69). In 2003, two other pensions schemes were created to cover individuals with a permanent disability and unable to work, and early retirees of the 'Trepça' mine (installed as a targeted, passive unemployment protection scheme). This whole basic social floor was to be financed from general revenues, and the expectation was that the spending would remain small. In addition, the designers expected that the market would grow in relevance and provide for the bulk of social protection, including through mandatory pension savings at the KPST, personal private pensions (Pillar III) and private health insurance.

**During UNMIK's administration of Kosovo, expenditure was controlled as GDP slowly increased.** As the tables above show, UNMIK stood by its design of social protection that was generally understood as leaning towards an ideal liberal social policy model. It only once changed the amount of the basic pension (2004) from EUR 35 a month to EUR 40 a month. As GDP grew, government revenue-based social protection expenditure did not increase at the same rate. On the other hand, given that the Kosovo Pension Savings Trust was newly created, there were only a few contributors to it who turned 65 years of age; far more entered it to create savings accounts. Personal pensions in the Pillar III and health insurance in the market remained trivial. This is why expenditure relative to GDP continually declined until independence.

**After the declaration of independence, government revenues were used to accommodate various social group interests.** The developments in the social protection sector that took place after independence were somewhat unexpected. Although there were limited existing skills in civil society after the war (Stambolieva, 2012), pensioners and former workers under Yugoslav self-management socialism criticised UNMIK for discontinuing PAYG pensions. During 2005 and 2006, they even proposed a law for Kosovo's Assembly to consider for the reintroduction of PAYG (which they called 'a European model' of pensions). This, like changes proposed by the Assembly

to social benefits for war invalids, was rejected by UNMIK. However, the League of Pensioners of Kosovo continued consultations with the main political parties, and in summer 2007 it signed a memorandum of understanding with the Democratic Party of Kosovo (PDK), which was seeking electoral victory. The PDK won that year's elections, Kosovo declared its independence in February 2008, and a specific pension financed from government revenues was created for former pension contributors (workers) under self-management socialism and termed a 'contributory pension'. In 2015, the highest such pension was EUR 240 (which took account of the number of years of contributions and the level of education), while the basic pension was EUR 75. It remains a very costly scheme, and will continue to grow over the next 15 years, although it covers only part of the elderly population, since the highest employment rate in Kosovo under self-management socialism was 23% (1986). Female recipients of this pension amounted to only 12% in 2015, since the maximum employment rate of women had been under 20%.

**The rest of the public pension schemes were created in the same fashion.** These schemes included an early-retirement pension for former members of the Kosovo Protection Corps in 2010, a similar one for Kosovo Security Force personnel in 2012, and another specific one for blind persons in 2014. These all offer considerably higher pensions than the basic pension. After 2016, there were more such pension schemes created or preannounced, and more social groups brought forward similar claims for inclusion.

**The most intensive changes occurred on the so-called 'categories of war'.** Soon after coming to power, in 2008 the PDK drew a distinction between benefits for invalids and the families of KLA members killed in war, and benefits for civilian victims; it also eased the eligibility criteria for the former. The PDK-led government revised this scheme continually, creating privileged education access and fee waiver, court fee waiver, electricity bill subsidies, recreation support, etc. In 2010, very close to that year's new parliamentary election, Parliament voted to establish lump-sum compensation of EUR 15 for every day spent in jail by all former political prisoners of Yugoslavia during the period March 1913 to June 1999. Close to another election in 2014, the PDK initiated a law which created monthly payments of EUR 170 for non-working KLA veterans. More than 50,000 veterans qualified for benefits.

**Changes in public pension and categories of war have transformed the goals of social protection institutions set under UNMIK.** These changes are the main drivers behind the recent rise in social protection spending. As a result of these changes, and other similar promised schemes (such as for ex-workers of parallel education organised from parallel Albanian institutions during the 1990s<sup>1</sup>), the expenditure financed by government revenues will continue to increase and will remain much more relevant than other sources of expenditure. The new schemes have also created asymmetries in payments and status between social groups, which has fostered a decline in trust towards, and satisfaction with, institutions.

**The decentralisation of power from the central to the local level was initiated by UN Envoy Martti Ahtisaari's proposal on the status of Kosovo.** Ahtisaari's proposal, following negotiations between Kosovo and Serbia that took place in Vienna during 2005-2007, suggested various solutions to increase the rights of the Serbian Orthodox Church in the management of orthodox sites, increasing the number of Serbian majority municipalities and their responsibilities, in exchange for Western support for a conditional independence for Kosovo. The proposal was not brought to a vote in the UN Security Council, but Kosovo's Parliament passed a package of legislation on the basis of it. This included a law regulating the powers of local administration, which in 2009 transferred and delegated to municipalities most responsibilities for managing social services and

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<sup>1</sup> During the 1990s, the Serbian regime excluded Albanian workers and students from the formal education and health system. In response, Kosovo Albanians organised a "parallel virtual state" that ran parallel education system for Albanian students and a parallel health system (not recognised by the state).

social assistance. However, due to poor monitoring of Centres for Social Work and municipalities' poor finance capacities, the development of social services was halted. Political interest began to rise only in late 2018, when a concept document was proposed by the MLSW (MLSW, 2018a) on enhancing services, challenging asymmetries, and creating more sustainable finances for social services.

**A law introducing mandatory health insurance entered into force in 2014, but has not yet been implemented.** The law was widely informed by a World Bank study on the health sector (World Bank, 2008); UNMIK and the World Bank had rejected two previous local initiatives. The law envisaged the establishment of a single statutory Health Insurance Fund (HIF), an autonomous body (like the Kosovo Pension Savings Trust) to manage health insurance funds. The HIF would be financed from contributions by employers and employees (3.5% of wages each) plus general government revenues covering social assistance beneficiaries. A wide range of groups will be exempt from paying such contributions: poor families claiming social assistance, prisoners, individuals living in state institutions, children in foster care and guardianship, older people and those with disabilities, repatriated people during the first year of repatriation, war casualties and their spouse and children, victims of trafficking during the first year after their official registration, permanent residents of informal settlements in Kosovo who are not registered, and victims of domestic violence. The law caused some controversy and public criticism, not least because it also envisaged (depending on a means test) a potential right to government revenue-financed insurance for beneficiaries of public pensions and 'categories of war'; many feared this would imply a further unjustifiable burden on the national budget. Its implementation has not commenced yet.

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

**Kosovo's existing cash side of the social protection system is relatively easy to manage by a small and unskilled staff.** The bulk of the system consists of cash transfers financed from government revenues. In some of the biggest cash transfer programmes – such as basic pensions, pensions for former workers under socialism, and people with permanent disability – the eligibility criteria are clear and cases are easy to evaluate. Therefore, the MLSW does not necessarily need highly skilled experts to manage and implement the programmes. These pension programmes, in addition, provide for 100% coverage of the old-age population with some form of pension income. In addition, the KPST (Pillar II) has been in a good financial position since 2002: it has received funds paid by employers and employees in the form of savings, but has had no large outgoings, because the number of its clients reaching 65 years is still small (around 4,610 in 2015). The KPST provides up-to-date regular information to the owners of the pension savings accounts about their savings, and regular information to the public at large through periodic reports on investments, savings and payments. It also grants access to various data for research etc.

**The existing financing structure does not create heavy labour costs.** Since most social protection is financed from general revenues, and mandatory pension savings charge only 10% of gross wages, Kosovo is the country with the lowest labour costs in the region in terms of financing social benefits. This may have had some impact on the reduction in the unemployment rate of 11.7 percentage points by 2016 (from 2005, when the unemployment rate was 40.4%) (KAS, 2005:25; 2016b: 23). The majority of jobs after independence were created in the private sector. However, international surveys suggest extensive informal employment and a smaller unemployment rate – e.g. the Millennium Challenge suggested that the unemployment rate in Kosovo was 16.3% in 2017 (Siddiqui et al., 2018).

**The weaknesses are more apparent than the strengths, starting with the unsustainable growth in public asymmetric transfers.** The continuous growth in expenditure financed by government revenues to accommodate the interests of various powerful social groups without prior contributions is unsustainable. Although overall expenditure in Kosovo relative to GDP is small, public spending on social benefits has been around 25% of the total national budget in recent years. Some of the benefits, such as those for KLA veterans, arguably discourage the veterans from seeking employment, since the benefits are not available when the veterans work. The Office of the Auditor General (2015) has reported cases where individuals have received more than one pension financed from the national budget, cases of continued payments after the death of a beneficiary, and cases where social assistance benefits have been paid even though the beneficiaries receive income from work – all against the law. Most active public discussions have focused on benefits for KLA veterans: although the KLA was reported to have had around 26,000 members, more than 50,000 people have qualified for benefits, leading to investigations for dubious claims. In several other cases, KLA veterans' associations did not provide reports on the use of transfers they received for in-kind services and recreation (OGA, 2015: 22-25). Beyond payment errors and dubious claims, the benefits have created asymmetric payments between beneficiaries. Most relevant cash transfers created since independence – pensions for former workers of self-management socialism, KLA veterans and former political prisoners – have essentially targeted the male and Albanian ethnic population. On the other hand, the government has shown no serious commitment to consolidating social services. These services require better-skilled personnel and a sound financing formula.

**Future savings at the KPST face uncertainty.** Kosovo's Pillar II (mandatory pension savings managed by the Kosovo Pension Savings Trust) is the most ambitious institution of its kind in the entire Balkans region. In other countries, employer-employee contributions either finance PAYG pensions alone, or they finance primarily a PAYG



pension programme, plus a small mandatory pension saving programme on the side. As such, Kosovo's future pension saving income for those generations that have entered work since 2002 (when the KPST was founded) will be highly dependent on the performance of western financial markets, where these savings are generally invested. Although the KPST has usually reported positive investment returns, there were huge losses in 2008 (EUR 92.5 million) and 2018 (EUR 85 million). The KPST applies a cautious approach in its investments, and pays among the highest salaries in the country for its top management; but concerns were expressed some years ago about potential political involvement in deciding where (at which entities) the investments were made (Marzouk, 2011). The leading political parties – the Democratic Party of Kosovo and the Democratic League of Kosovo – both enjoy considerable influence at the KPST and the Central Bank of Kosovo.

**The existing social protection expenditure is not well positioned to help reduce poverty and inequality in the country.** Since around 95% of all social protection expenditure is financed by government revenues (as Table 1 showed) and national revenues are up to 85% financed from consumption taxation, this structure implies that there is low redistribution. The national revenues come disproportionately from the poorer part of society (which has to consume more of its income than the better-off, who can save/invest), whereas the revenues are spent mostly on public-sector wages and – increasingly – on cash transfers to powerful social groups. This is one of the reasons why the effectiveness of social transfers in reducing poverty and inequality is declining (ESPN, 2019); other reasons include the inadequacy of transfers, small transfers in the categories of basic pensions and social assistance relative to living conditions, etc. On the other hand, small charges on employers for financing pension savings (5%) and a low top bracket for personal income tax (10%) have helped the concentration of income around capital holders and high earners. Work income is the most effective mechanism for reducing poverty and inequality, but the employment rate grew by 1 percentage point over a decade – from 28.1% in 2005 to 29.1% in 2016. Inequality in income and social benefits is a strong factor behind outmigration, which in 2016 amounted to 10% of Kosovo's 2011 population.

**Interest in social insurance is rising.** In January and February 2019, the Ministry of Health stated publicly that it plans to move ahead with implementation of mandatory health insurance in late 2019. There are discussions that a new law will precede the implementation, and it is expected that the new law will largely follow the concept adopted in 2014 (its exact provisions remain undecided). On the other hand, there have been informal discussions among some political parties in Kosovo about following the health financing model that applies in the UK, Sweden, Spain, etc. These discussions were also reflected in the recent Concept Document of the MLSW, 2018b), which suggests that the health sector could be financed from national revenues, rather than contributions, but it would be managed from an autonomous fund. There are fears that in the particular context of Kosovo, if mandatory health insurance commences with implementation based on the existing (2014) concept, it could have various negative consequences, such as: increased public revenues spent on public-sector wages in the form of employer (government) contributions; potential increased public revenues spent on health insurance benefits for various social groups (such as pensioners, KLA veterans, political prisoners, etc.); small contributions received from employers and employees due to the low employment rate; exclusion of the unemployed population if not officially deemed poor; and most health insurance funds being used to pay for services at private health service providers, etc.

**The Ministry of Labour and Social Welfare has proposed creating a Social Insurance Fund.** Aiming to prevent the further growth in expenditures and schemes financed from government revenues, the MLSW initiated a concept document of reforms in late 2018 (see ESPN, 2018). The document proposes establishing a Social Insurance Fund to manage old-age pensions, pensions due to disability at work, sickness allowances, unemployment protection and children's allowances. The fund would be financed by employer and employee contributions (initially 1.5% each). The old-age

pensions financed from the fund would kick in only after the pension savings with the KPST are spent. The document further proposed transforming the existing basic pensions into a means-tested pension issued only in cases of no prior work history or to complement low pension income. Despite different views on its details, various relevant international organisations have backed the orientation of the document and its assessment of the current situation.

**The Social Democratic Party of Kosovo has now taken the lead on an ad-hoc committee created by Parliament to prepare a new law on pensions and social insurance.** On 2 February 2019, Kosovo's Parliament voted the national budget for the current year. The governing coalition needed the votes of the Social Democratic Party (SDP) in opposition to get the budget passed, and in exchange the SDP took the lead on an ad-hoc committee (not backed by other opposition parties) to prepare a unified law on pensions and social insurance benefits. Although it is too early to predict the outcome of the work of the committee, it is expected that the SDP will crucially want to create a main PAYG pension pillar and reduce the charges for KPST pension savings (currently 10%). It is highly likely that, like the MLSW's concept document, the new law will also introduce some insurance on risks such as unemployment, invalidity at work, long-term sickness, cash protection for children, etc. The SDP said that it wanted to draft the law by the end of June 2019, but it was still working on the draft in late July.

#### *A limited set of policy recommendations*

**The current discussions in Kosovo's public sphere concerning social protection should be utilised by following them up with positive reform.** In line with the existing discussions, described above, one of the aims of the reform should be to restrain government revenue expenditures on cash transfers. Criteria should be established that are as universal as possible in terms of eligibility and payments (valid for all citizens and communities), rather than continuing with (and allowing an increase in) separate schemes and asymmetric rights for powerful groups. Since decisions on the amount of benefits are often taken on an ad-hoc basis and near election dates, according to the mood of politicians in power, it would benefit the protected population if the amount of cash transfers were to be linked automatically to a defined percentage of family disposable income or individual market wages. This would make the transfers better able to contain and reduce poverty, since they would follow market fluctuations, and electorally motivated decisions would be avoided. There should also exist a specific line in the national budget on financing entire social services.

**Kosovo should explore a better mix of finance sources, in particular by utilising contributions; but the discussions on the right balance should be informed both by local context and by European developments.** Another goal of the potential reform should be a rise in the relevance of contributions in financing social protection for social risks such as old age, invalidity at work, long-term sickness, unemployment protection, etc. However, in doing so, the government must find the right balance. The low employment rate implies that the contributions will produce limited budgets, and the low capacities for quality governance of public institutions (as demonstrated by the current crises at Kosovo Post-Telecom) suggest that it would be difficult for the Ministry of Labour and Social Welfare to recruit qualified human resources and successfully manage contributions. These points should be seriously considered before any decision on the future saving charges (contributions) for the Kosovo Pensions Savings Trust is taken. In addition, European-level developments show that the population is ageing, the nature of jobs is often changing (e.g. part-time and short-term jobs are more prevalent), and in various countries (such as Sweden and Norway) the contributory pensions are dissimilar to the former Yugoslav PAYG pensions, in that: they are mixed with other pension sources, they seek to contribute to social equality, and they are managed and invested from several funds. Therefore, rather than re-traditionalise the system, the reformers must take into account the newest best practices in terms of contributory pensions.

**Progressivity in personal income tax should be strengthened.** During UNMIK's administration of Kosovo, the top bracket for personal income tax was 20%. The highest bracket was reduced to 10% in 2008 by the Parliament of Kosovo. In order to allow future social protection reform to better fight poverty and inequality, progressivity in personal income tax should be increased; this will ensure that less income is concentrated in the hands of the top deciles. In contrast to this, since independence, most enlargement of the tax base has come through increasing VAT. Parallel to the strengthened progressivity, various tax and contribution incentives can be used to support the employment of low-skilled individuals, youth and women. The policy of applying only a 5% charge on employers for pension contributions (thus low labour costs) and expecting the market to provide job miracles without an active and innovative labour policy from the government has proved largely ineffectual.

**The National Health Insurance model should be considered in the context of Kosovo, especially in the short term.** The existing government revenue-financed healthcare, including the essential national list of drugs provided free of charge, would be better managed and rationalised from a specialist autonomous fund. Due to the low employment rate and the risk of creating a high level of social exclusion and asymmetry – as described above – the model of a National Health Insurance financed by government revenues could be more feasible for Kosovo in the short and medium term. According to this model, access to healthcare would be governed by citizenship, and it would cover any spending on a list of services and drugs by individuals above a defined limit. At the same time, citizens could further utilise voluntary private health insurance. This model is closer to the existing culture and public expectations of healthcare than is typical of mandatory health insurance.

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