

KOSOVO*

TECHNICAL BACKGROUND PAPER SOCIAL SECTORS

7 July, 2008

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The paper is intended to inform discussion at the 11 July Kosovo Donors' Conference by providing further information on this sector. The paper also aims to facilitate improved donor co-ordination and aid effectiveness at a sectoral level after the Conference.

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KOSOVO

***Donors Conference,
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POLICY ISSUES IN THE SOCIAL SECTORS

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Preface

Within the context of slow growth in recent years and fiscal pressures, Kosovo faces the complex dual challenges of high unemployment and weak human development outcomes. Promoting the “jobs agenda” and strengthening human capital rank high among priorities for Kosovo’s development. Labor demand is still stagnant and establishing an environment for strong and sustainable job creation will be a challenging task involving reforms both outside and inside the labor market. In the short- to medium-term, as prospects for economic expansion and job creation improve, some actions can be taken to alleviate unemployment. At the same time, institutions and legislation can be put in place to support a better functioning labor market. At the same time, the Government should consider strengthening and expanding a well-targeted social assistance program (possibly even along the lines of a conditional cash transfer) – provided it can do so within the context of limited fiscal space. Containment of pressures to expand pensions or war veterans’ benefits will be crucial from a fiscal standpoint. Opportunities also abound to help build Kosovo’s depleted human capital. In education, priority actions include: strengthening the overall institutional foundations for the sector, expanding access to secondary school, strengthening teacher training and incentives, supporting the expansion and improvement of higher education, and developing a policy and organizational framework for lifelong learning. In health, priorities include strengthening quality, service delivery, and planning and management in the sector.

This paper presents policy issues confronting Kosovo in the social sectors and is accompanied by four more detailed Annexes:

Annex I – Pension Policy Reform for Kosovo;

Annex II – Supporting the Development of Education in Kosovo: Key Challenges and Policy Options;

Annex III – Reconfiguring the Health Sector: Developing a Master-Plan for Kosovo; and

Annex IV – Kosovo Health Financing Policy Note.

I. ECONOMIC AND SOCIAL CHALLENGES

Economic Context for Social Policy: Slow Growth and Fiscal Containment Pressures

1. Kosovo is confronting many complex economic challenges. While estimated GDP growth picked up modestly from 2 percent in 2005 to 4.4 percent in 2007, Kosovo remains the slowest growing economy in Southeast Europe. It is also the poorest economy in the sub-region, with an estimated per capita GDP of only €1,573 in 2007. CPI inflation, which had remained negligible until 2006, has recently accelerated to over 10 percent, largely fueled by the impact of higher global food and energy prices. With a limited export base, Kosovo relies heavily on donor assistance, spending by foreigners present in Kosovo, and remittances to finance its massive trade deficit. Despite a relatively low overall tax burden and rates of labor taxation, informal employment remains significant.

2. At the same time, Kosovo does have a potentially favorable investment climate if political stability and sound policies are maintained. Regarding labor costs, wage and income tax levels are relatively modest, although high relative to labor productivity comparators with neighboring countries. In 2006 the average monthly salary was Euro 236, and income tax on average wage levels was only 5 percent. The pension system consists of a tax-financed basic pension with a requirement that employers and employees each contribute 5 percent of gross wages to a retirement savings account, which results in a relatively low level of labor taxes compared to neighboring countries. Kosovo is not encumbered with excessively burdensome minimum wage laws. Taxes in Kosovo are low compared to neighboring countries. Kosovo has a simple and quick business registration procedure that takes only three days to process. It is vital that Kosovo does not undermine any of these advantages through inappropriate policies.

3. Given Kosovo's use of the Euro as legal tender, fiscal policy is its only tool for macroeconomic management. This places the maintenance of sound fiscal policies at the center of the agenda for sustainable growth and employment generation. In 2006 and 2007, Kosovo ran significant budgetary surpluses of 2.5 and 7.3 percent of GDP, respectively. However, these surpluses were unplanned, and reflected the combined effect of: (i) unexpectedly strong revenue growth; (ii) significant under-execution of the capital budget; and (iii) the financing of certain social programs below levels which can be sustained in the medium-term. In fact, Kosovo's recent fiscal performance has been underpinned by tightly contained current spending, which reached only 16.7 percent of estimated GDP in 2007 – well below levels observed in neighboring economies.

4. From 2008 onwards, IMF projections show such surpluses giving way to small deficits, even under the assumption that pressures for increased current spending remain broadly contained. This partly reflects an envisaged (and necessary) increase in the execution rate on capital and other development spending. It also reflects new commitments resulting from the implementation of Kosovo's new constitution which envisages that the Kosovo authorities will take on roles previously performed by United Nations Mission in Kosovo (UNMIK).

5. However, maintaining such modest deficits and hence a sustainable macroeconomic policy framework, will only be possible if Kosovo can successfully manage a range of social pressures for very large and poorly planned increases in social spending. At this juncture, the government is facing such pressures on a number of fronts, from trade unions, from pensioners, from teachers, from war veterans, from employees of the Trepca mining complex, from the Kosovo Protection Corps, from the poor, from the unemployed, and from employers. Some needed reforms, such as providing increased incentives for teachers' strong performance and expanding the under-funded but well-targeted social assistance system, will necessarily put upward pressure on current spending and the budget balance. In this context, it is all the more imperative to maintain control over expenditures on war veterans, and pensions, and avoid resorting to increasing payroll taxes which would further depress employment levels, especially in the formal sector.

The Dual Challenges of High Unemployment and Weak Human Development Outcomes

6. Promoting the “jobs agenda” and strengthening human capital rank high among priorities for Kosovo's development. Indeed, Kosovo's post-conflict economic recovery, although supported by extensive foreign assistance and private inflows, has failed to lead to significant creation of jobs and to tackle its weak stock of human capital. These challenges are particularly complex, given Kosovo's relatively young and ethnically diverse population, recent socio-political history and post-conflict context as a fragile state.

7. **High Unemployment.** Unemployment has remained stubbornly high since 2003, especially for youth. Overall labor force participation remains stagnant at the lowest levels in the sub-region (Table 1). About 30 to 40 percent of all workers in Kosovo across all age groups work on a part-time basis. While among females this partly occurs because of their role as caregivers, among men this mainly occurs because they cannot find a full-time job. With respect to the overall working-age population, estimates suggest a decline from 52 percent to 45 percent in overall unemployment rates and an increase in employment rates from 25 percent to 29 percent for the working-age population in 2005 (Table 1).

8. The situation is especially dire for youth, with reported youth unemployment hovering around 76 percent in recent years. The challenge of youth unemployment is particularly daunting given that Kosovo has the youngest population in Europe (with youth aged 15-24 averaging 31 percent of the working-age population and 20 percent of the total population) and relatively high fertility rates (2.7). Indeed youth in Kosovo tend to face “triple jeopardy” – defined as being young, unemployed and extremely poor. These vulnerable youth comprise approximately 33,000 young individuals (generally low-skilled, female, and living in rural areas). They are likely to be the group most vulnerable to social exclusion, long-term poverty, and lack of second chances in Kosovo. Youth in Kosovo display a very difficult transition from school to employment. In 2006, only 5 of every 100 youth successfully transitioned from school to employment in stable employment..

9. Moreover, joblessness is a key cause of income poverty, reflecting the difficulty of the Kosovo economy to generate sufficient viable jobs.¹ Approximately 45 percent of the

¹ World Bank (2007), Kosovo Poverty Assessment.

population live in poverty, i.e. below €1.42 per day, and 15 percent in extreme poverty, i.e. at or below €0.93 per day.² Children and young people under the age of 24 are disproportionately likely to live in extreme poverty. Those younger than 25 comprise about 57 percent of people facing extreme poverty, with young people aged 15 to 24 comprising 22.4 percent.³

Table 1: Unemployment in Kosovo

	<i>YOUTH: Age Group 15–24</i>			
	Employment Rate	Unemployment Rate	Labor Force Participation	Inactivity Rate
2003	10.7	76.6	45.7	54.3
2004	12.7	63.9	35.0	65.0
2005	10.6	70.9	36.4	63.6
2006*	11.5	75.5	46.9	53.1
	<i>WORKING-AGE POPULATION: Age Group 15–64</i>			
2003	25.3	52.3	53.0	47.0
2004	28.6	39.6	47.4	52.6
2005	28.8	41.5	49.3	50.7
2006*	29.0	44.6	52.3	47.7

*Estimates from SOK (2006).

Source: World Bank Estimates using 2003–2005 LFS data.

Table 2: Regional Comparison of Labor Market Indicators

	Labor Force Participation (%)	Employment (%)	Unemployment (%)
Bosnia	74.7	66.7	31.8
Serbia	66.2	61.9	15.2
Albania	64.7	57.3	14.4
Bulgaria	64.5	58.6	8.1
Romania	63.6	58.8	7.2
Macedonia, FYR	60.6	38.3	37.3
Kosovo	49.3	28.8	41.5
EU15	71.6	66.0	7.4
EU27	70.2	64.4	7.7

Source: ILO KILM 2007, Eurostat (Bulgaria, Romania, EU aggregates), WB Calculations (Kosovo)

10. **Weak Human Capital Outcomes.** Kosovo also has the lowest human development indicators in South Eastern Europe. In **education**, whilst net primary school enrollment is high (95 percent), net secondary enrollment (75 percent) and tertiary enrollments (16 percent) are lower than neighboring countries (Table 3). This indicates a problem of retention and high drop-out rates. The transition to secondary school remains a barrier for many children, particularly girls and the poor—81 percent of boys/children in the richest quintile are enrolled in secondary education but only 67 percent of children in the poorest quintile and 66 percent of girls are enrolled (Figure 1). More serious however, is the poor quality of much of the education

² The groups most at risk in terms of income poverty include children, the elderly, female-headed households, the disabled, the unemployed, precarious job holders, residents of secondary cities, and non Serb ethnic minorities.

³ UNDP Kosovo, Kosovo Human Development Report 2006 – A New Generation for a New Kosovo.

provided, exacerbated by high teacher absenteeism and multiple-shift schools which reduce the effective teaching day.

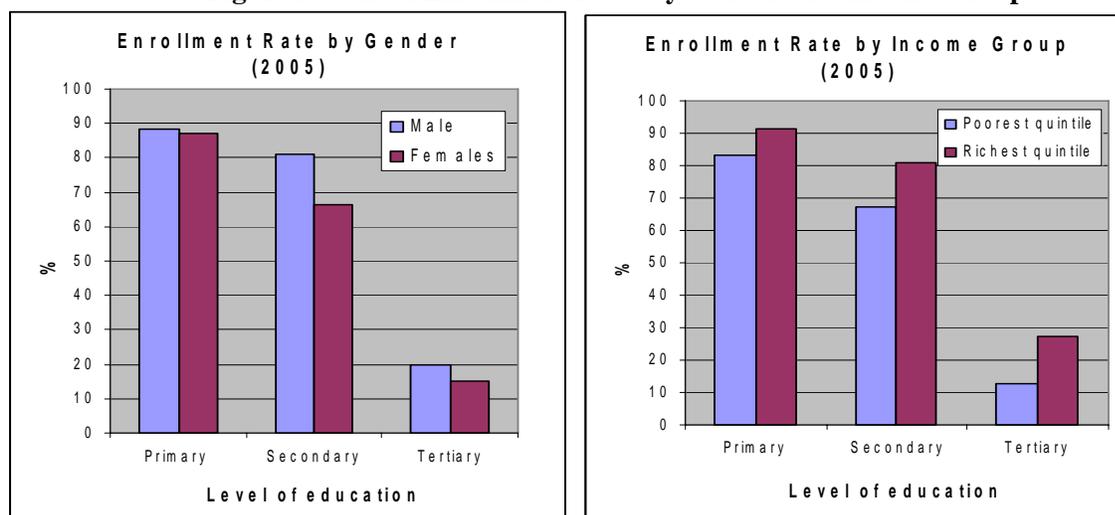
11. These problems are exacerbated by low quality in education, undermining Kosovo's drive for modernization and meeting the Lisbon Agenda of the European Union (EU). Although the data on student learning is very limited, a recent pilot assessment of children in grade 5 shows poor learning outcomes, particularly in mathematics.

Table 3: Regional Comparison of Education Indicators

	Education Indicators			
	Net Primary School Enrollment (%)	Net Secondary School Enrollment (%)	Gross Tertiary Enrollment (%)	Public Expenditure on Education (% GDP)
Bosnia and Herzegovina	97.2	66.0	-	5.8
Bulgaria	92.9	89.1	43.7	2.46
Croatia	87.3	85.0	43.9	4.40
Kosovo	95.4	75.2	16.0	4.56
Macedonia, FYR	91.8	81.3	29.8	3.50
Moldova	85.9	75.8	33.9	7.62
Poland	96.7	92.9	64.1	5.41
Romania	91.3	80.8	45.2	3.29
Serbia & Montenegro	95.8	88.7	22.3	3.3
Slovenia	98.2	94.4	81.2	6.0

Source: World Bank World Development Indicators, IMF, World Bank Calculations, UNESCO.

Figure 1. School Enrollment Rates by Gender and Income Groups



Source: World Bank (2007). Kosovo Poverty Assessment.

12. **In health**, there is a lack of information on outcomes, including morbidity and mortality statistics that could be used for international comparison. Kosovo does not collect data on

common health indicators, including basic demographic indicators; lifestyle- and environment-related indicators; mortality, morbidity, and disability; and health care resources, comprehensive utilization, and expenditure. The existing data on the population's demographic characteristics and health status are highly contradictory, and highlight the need for investment in better monitoring and evaluation capacity at the Ministry of Health (MOH). This lack of data prevents analysis of trends and comparisons of international health statistics that could help to support the formulation and monitoring of health policy at the national level.

13. Public spending on health is about 3 percent of GDP in 2005, though this has declined as a share of overall Government spending (from 10.4 percent⁴ in 2004 to 9.6 percent in 2005).⁵ Out-of-pocket payments made by patients contribute about 55 percent of total health spending⁶, and constitute a barrier to access to care for the population, leading to inequity in access to care. Outpatient facilities and hospitals report very low utilization rates. In 2006, Kosovo reported second lowest visit rates for outpatient care in Europe with 1.9 visits per capita, and the lowest hospital admission rate (Figures 2 and 3). Productivity in hospitals and primary health care (PHC) centers is low as indicated by relatively low bed occupancy rates, a low-severity case-mix of patients in hospitals who could be treated in outpatient settings, and low patient to staff ratios in PHC facilities. Low utilization rates in public health facilities suggest that patients who can afford to pay high user fees seek care in the private sector, and outside of Kosovo (primarily in the Former Yugoslav Republic (FYR) of Macedonia, in Montenegro, and in Serbia). These findings all suggest that there are significant barriers in access to health care, particularly among the poor.

14. **Kosovo needs to make considerable progress to improve basic health indicators.** Child and infant mortality are considered to be the most complex issues impeding Kosovo's development, viz United Nations Development Program 2007. Major investment in the quality of basic health is needed to improve health (Table 4). Life expectancy at birth is lowest in the South Eastern Europe region—69 years in Kosovo, compared with 73 years in Serbia and 74 in Bosnia and Herzegovina, suggesting that the Millennium Development Goals (MDGs) are not the only health challenge in Kosovo and highlighting the need to establish comprehensive health statistics as reported by most European countries.

Table 4 - Reaching the MDGs in Kosovo

Indicators	Kosovo 2002/4	Kosovo 2006	MDG Goal 2015
Perinatal mortality (per 1,000 live births)*	27 (b)	23(b)	9
Maternal deaths (per 100,000 live births)	22 (b)	7 (b)	5.5
Number of new TB cases per year	48 (c)	58 (d)	26
Number of new AIDS cases per year **	4 (c)	2 (d)	Reverse spread
% of rural population with access to safe water	72% (e)	78% (e)	>80%

Sources: (a) HBS 2002; (b) UNDP 2007; (c) Kosovo HIS 2004; (d) Statistics Office of Kosovo 2006; (e) World Bank 2007; United Nations 2000.

⁴ Public Expenditure and Institutional Review (PEIR) 2005. The World Bank.ss

⁵ Kosovo National Health Accounts (NHA). June 2007. The World Bank.

⁶ PEIR 2005. The World Bank.

Note: *Perinatal mortality serves as a proxy for child mortality. No valid data on under 5 and infant mortality. **The low number of new HIV/AIDS cases could be due to underreporting and points to a need to strengthen the surveillance system.

Figure 2: Outpatient visits per person⁷

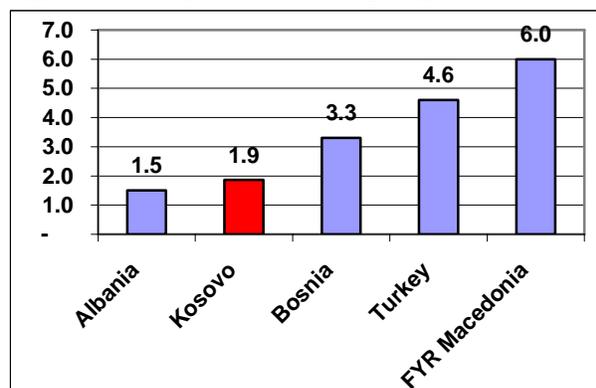
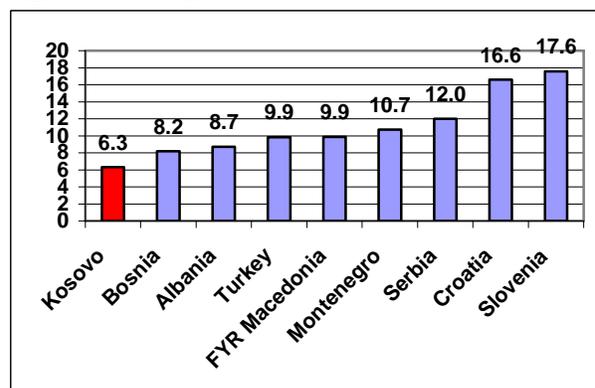


Figure 3: Hospital Admission Rate



II. ACTION AREAS FOR POTENTIAL DONOR SUPPORT IN SOCIAL POLICY

13. Kosovo wishes to address these issues of high unemployment and poor human development outcomes urgently, and in a fiscally sustainable manner, and is requesting both the technical advice and financial support of the Bank and the donor community in the design and the implementation of these reforms.

A. EMPLOYMENT

**Priority Actions for Employment:
Establishing the Framework for Longer-Term Job Creation and Alleviating
Unemployment in the Short-Run**

14. The key issue in employment is the low demand for labor due to a generally unfavorable climate for investment and job creation. Significant improvements in the economic situation and in the dynamism of the private sector requires a long-term and multi-sectoral strategy that largely falls outside of the labor market – e.g. maintaining macroeconomic stability, and improving the investment climate. With respect to the latter, it is important to identify exactly which aspects of the business environment are the most serious barriers to investment and firm creation and expansion. This will require diagnosis not only of the rules in place but also their implementation in order to better understand which reforms will be needed in order to remove existing barriers “on the ground” to job creation.

⁷ Source for both Figures: Kosovo Health Statistics 2006; and WHO Euro Health for All databases. <http://data.euro.who.int/hfad/>

15. At the same time, labor market policy reform can also contribute to a better environment for job creation. Two potentially important issues are the regulatory framework and labor costs. International evidence has shown that labor market regulations – including those determining hiring and firing and the deployment of workers -- can have significant impacts for employment, especially in the formal sector. The existing labor legislation does not appear to be a significant barrier to employment, although some recent new drafts could introduce some very costly rigidities (i.e., relating to severance and minimum wages). The legislation and these proposals need to be carefully reviewed in order to assess their implications for the labor market. In particular, labor market regulations can have especially important impacts on the job opportunities of young people and women and this should be taken into account in this diagnosis.

16. The other aspect of the labor market framework that requires analysis is wages and other labor costs. There are concerns that distortions in the labor market may be resulting in a situation where the productivity of workers is low relative to their (Euro-based) wages. In particular, the substantial activity driven by the international organizations may be creating upward wage pressures in the labor market (a kind of “Dutch-disease effect”). Analysis is needed to determine the extent to which wages, and the additional non-wage costs coming from social charges and other obligations, are acting as an additional constraint on employment; however, as noted earlier it is extremely important not to increase payroll taxes due to the negative effect on employment generation. Obviously, productivity growth -- and the higher equilibrium wages that would result – is central to the longer-run welfare of the labor force. This closely relates to the human resource development issue that is discussed elsewhere in this document.

17. In addition to favorable regulatory and labor cost regimes, the other cornerstone of a job-friendly labor market framework is the capacity to deliver cost-effective active labor market programs (ALMPs). While employment services and training programs are of limited use in a labor market as slack as Kosovo’s is currently, they can play a useful role in enhancing the functioning of the labor market and improving the employability of job-seekers and other disadvantaged workers, especially as labor demand picks up. The Public Employment Service (PES) has very limited capacity and severe budget constraints. Starting to build capacity of the PES now would be a useful measure for the future. Kosovo has a draft Employment Promotion Law that should be reviewed in terms of whether it establishes an appropriate regulatory framework for ALMPs. It is important that this framework provide for the possibility of private delivery of programs and services and competition in a “quasi-market” for employment services and training programs.

18. While the reforms discussed thus far will be important for establishing favorable labor market conditions in the future, there are very strong reasons to consider measures that could have more immediate impacts in terms of creating jobs and alleviating unemployment. Admittedly, interventions to directly create jobs are controversial since they can have significant costs and uncertain benefits, especially beyond the short-term. However, in the case of Kosovo where there is so much slack in the labor market, there is a strong case to seriously consider such options.

19. Policy-makers essentially have two options to immediately stimulate employment -- public works/workfare and subsidies on wages or social insurance. Public works programs have proven to be an effective measure for creating short-term employment for truly jobless workers if they

are carefully targeted and if the wage is set below the equilibrium wage for unskilled labor.⁸ This may be an appropriate intervention for needy prime-age workers who have little chance of finding scarce private-sector jobs. On the other hand, wage or social insurance subsidies may be more appropriate for young people, to get them into real workplaces (ideally with some training) so that they can get a foothold in the labor market. Analytical work would be required to assess these options and to propose potential designs that ensured desired targeting, incremental job creation with minimal substitution and deadweight effects, and limited distortionary effects in the labor market. These measures would be more justifiable, of course, if the reforms with a longer term effect that were discussed above are seriously implemented at the same time.

20. Safety-nets targeted to youth in jeopardy can have an important impact in reducing extreme poverty. Using micro-simulation techniques (World Bank 2008), analysis quantifies the impact on poverty of targeted active labor market programs (ALMP) which provide extreme poor households having youth with a transfer equivalent to the youth median monthly wage (about €106.7 per month) vs. the same transfer randomly allocated among a sample of households having unemployed youth. The transfer can be thought of as income assistance through a targeted income transfer and/or targeted employment assistance. Simulation estimates indicate reaching 6,000 disadvantaged/poor youth with such an intervention can contribute to decreasing extreme poverty by 12 percent (that is, can contribute to getting up to 41,000 individuals out of extreme poverty, which are those living in households with a young beneficiary) while the effect of a randomly allocated ALMPs would contribute to decreasing extreme poverty by only 3 percent. Implementing such a program would cost approximately €1.5 million per year (which is slightly above the budget currently spent on ALMPs targeted to youth).

21. Lack of donor coordination has contributed to the proliferation of small-scale employment programs targeted to youth. Most programs targeted to promote youth employment in Kosovo are either financed or implemented by donors. As such, donors play a major role in defining the policy agenda. However, not all donors seem to have a common agenda in relation to programs and policies that should be implemented. While some donors seem to have higher preference towards vocational education and training (VET)-related programs, other donors seem to have higher preference for programs that promote employment (temporary or permanently), such as apprenticeships and entrepreneurship support. As a result, there is a proliferation of expensive programs with limited scope and coverage.

22. About €7 million is spent on youth employment programs yearly, yet program coverage remains low. The level of yearly expenditure on ALMPs in Kosovo in 2007 slightly surpassed that envisioned in the Kosovo Youth Employment Action Plan. However, in year 2007 ALMPs benefited only 10 thousand youth per year (about 6.3 percent of all the pool of unemployed individuals in this age group). ALMPs currently being implemented in Kosovo have high unit costs (averaging €700 per beneficiary per year)

23. The success of VET-related programs is being undermined by the sluggish growth in labor demand. Although most resources for youth ALMPs are spent on VET-related programs (about €4 million per year), placement rates of trainees are very low. Indeed, the success of

⁸ See Subbarao and Betcherman et al. (2004) for a stocktaking of these programs and their impacts.

these programs is being undermined by the general sluggish demand of labor in the territory. In 2007, 3,022 registered unemployed entered a vocational training through the PES, of which 2,381 trainees graduated (79 percent of the entries). Only 40 percent of male graduates of PES training centers, and less than 30 percent of females' graduates found paid employment upon training completion. This is much less than placement rates (at 70 percent on average) in most other transition countries.

B. SOCIAL PROTECTION

Priority Actions in Social Assistance:

Expanding and Strengthening Targeted Program and Considering Potential for CCTs

24. **The Kosovo Social Assistance Program was introduced in 2001 with the goal of supporting the poorest segments⁹ of the population by providing cash benefits.** Two categories of poor families are currently being supported: (i) those without any member of the family capable of working, and (ii) those with only one member capable of working, but who is registered as unemployed with the PES of the Ministry of Labor & Social Welfare (MLSW) and is actively seeking work, and with at least one child under the age of 5 or an orphan under the age of 15. The level of the benefit depends on the other resources of the family and on the size of the family, ranging from €35 to €75 monthly, with the average being €52. Currently 37,392 families are receiving benefits, which cover a total of 161,863 individuals. The benefit was supposed to have been indexed to inflation but has not been increased since it was initially converted to euros in 2003.

25. **Available evidence suggests that the Kosovo Social Assistance Program is an efficient vehicle for transferring resources to the poor, but that it could be expanded and strengthened.¹⁰** Targeting outcomes are relatively strong – with about 45 percent of benefits reaching the poorest quintile of the population and only 6 percent going to those in the richest quintile (such that the program outperforms comparable schemes in Albania, Bosnia, and Serbia). However, only about 23 percent of the poor and 34 percent of the extreme poor are being reached by the social assistance program and unit values of the benefits are insufficient to bring beneficiaries out of poverty (above the extreme poverty line).¹¹ Priority actions could involve (a) maintaining or increasing funding for the program to top of the level of benefits and/or expand targeted coverage of the poor; and (b) providing technical assistance to strengthen program management, oversight and monitoring and evaluation of the program, including formalizing good practice in decentralized targeting practices. As budgetary room develops, broader coverage of the extreme poor as well as an increase in the benefit level to reduce extreme poverty would be beneficial. The objective would be to try and contain costs in other

⁹ Based on the latest poverty assessment for Kosovo (World Bank, 2007), almost 15 percent of the population is estimated to be extremely poor and unable to meet basic nutritional needs, while 45 percent consume below the poverty line.

¹⁰ Gueorguieva, Anna. Policy Note on the Kosovo Social Assistance Program: Good Program, Good Investment. April 25, 2008

¹¹ Recent amendments to the social assistance law have been presented to Parliament, including measures to simplify administration, which could free up some fiscal space and allow the Ministry of Labor and Social Welfare to increase the level of benefits paid. The proposed increase is €5 per month per family so that the available benefits will now range from €40 per month to €80 per month, depending on the number of individuals in the household. For the minimum benefit, this increase represents no more than the cumulative increase in the cost of living since the benefit was first established, but for the larger households, the flat increase of €5 per month does not even cover the cumulative inflation.

areas to allow this expenditure item to increase. These actions take on particular importance given the current global food price crisis.

26. **There could be a role for conditional cash transfers (CCTs) in Kosovo.** CCTs have been used in dozens of countries around the world, with the dual goal of reducing current poverty (through targeted cash transfers to poor families with children) and reducing future poverty through improved human capital (by conditioning benefits on human capital investments, such as attending secondary school). Significantly higher drop-out rates among the poor at the secondary-education level suggest a potential role for conditional cash transfers in helping alleviate demand-side constraints. Evidence does suggest that demand-side constraints prevent access for the poor (and particularly poor girls) to education. Cash transfers conditional on school attendance could help alleviate these constraints, providing incentives for children to enroll, attend and stay in school longer. In Kosovo, given that the existing Social Assistance Program appears to be an efficient vehicle for transferring resources to the poor, one option could be to expand coverage to target poor families with children and introduce education- (and possibly health-) related conditionality's. Alternatively, a new program could be considered, though it should be noted that most CCTs around the world have taken around 18 months to design, launch and refine to function adequately with necessary systems in place for monitoring and oversight.

Priority Actions in Veterans Assistance: Containing Costs and Capping Benefits

27. **Spending on effective social programs – such as the targeted Social Assistance Program or potential CCTs – competes with more generous outlays on veterans benefits, which are not targeted to the poor but are also highly politically sensitive.** Based on the so called “Law on War Martyrs” of 2006, five categories are eligible to life pensions: Kosovo Liberation Army (KLA) invalids, family members of KLA war victims, family members of war-related civilian dead, war-related civilian invalids, and family members of missing persons.¹² In the first year of implementation (2007), only the first two categories, KLA invalids and family members of KLA war victims were paid out benefits and were receiving only 70 percent of the amount the law indicates. In 2008, the MLSW was allocated a total of 20.5 million euros, an amount considered to be sufficient to pay out the full pension benefit to all five categories. As of March 2008, pensions were paid out to 9,600 cases in all five categories, with the MLSW estimate of the total number of potential beneficiaries to be close to 12,000. During March - April 2008, they were processing on average about 100 - 150 new applications. The Assembly

¹² According to the law, the base for the pension is linked to the minimum salary paid in the previous year which according to MLSW is determined by the Economic and Fiscal Council, which is an advisory body to the Special Representative of the Secretary General (SRSG) chaired by the SRSG and comprises three senior UNMIK officials, the Prime Minister and three Ministers. The amount for minimum salary used in determining the current benefits is €130 per month, which was determined to be the minimum salary in 2006, the last year for which such a value was calculated. The base for a full KLA invalid pension is 140 percent of the minimum salary and the pension is determined by level of disability. The benefits range from a full pension provided for 80 percent of disability (€182 monthly) down to 30 percent of full pension for 20-30 percent disability (€54 monthly). A family with one KLA war victim is eligible to 180 percent of minimum salary (€234 monthly) and the benefit increases depending on number of war victims per family (up to €351 monthly for a family with more than four war victims). A family of a civilian victim receives 100 percent of minimum salary (€130 monthly). A civilian invalid of war with 80 percent of disability is entitled to 90 percent of minimum salary (€117 monthly). The families with one missing person are entitled to 180 percent of minimum salary (€234 monthly) and the pension is dependent on the number of persons missing and goes up to €351 monthly for a family with more than four people missing.

Committee on Health and Social Welfare is due to review and amend the War victims Law this year. However, no amendments have been put forward by the MLSW as yet.

28. **Unlike the veterans' laws in neighboring countries of the region, the law does not require any means-testing of beneficiaries before granting benefits.** The benefits are quite large, and for some categories they are well above the average wage of implemented under the same provisions and criteria. Relative to the level of other social benefits which range between €40 and €70 per month, these benefits are considerable and exist for life for the eligible beneficiaries. In a country which experienced war a majority of families have suffered deaths and invalidities, and the number of beneficiaries might eventually be much higher than estimated. While war veterans' issues are always sensitive, the scope of this law is likely to be unaffordable if it continues to be implemented under the same provisions and criteria.

29. **The Government should try and contain costs in the implementation of this law by capping them in real terms, or even in nominal terms,** which would then provide the fiscal space to allow an expansion in both the eligibility and level of benefits provided by social assistance. While a means-testing procedure may not be politically feasible at this time, the indexation of these veterans' benefits to inflation, maintaining their real value, but not increasing as wages grow may be a useful method of cost-containment. The benefits are currently linked by law to the minimum salary and thus subject to rise with wage growth. Currently there is no minimum salary in Kosovo, but if one were to be established, as has been suggested by a proposed labor law, the benefits would automatically rise with the rise in minimum wage. Alternatively, the Government could establish a maximum budgetary expenditure on veterans' benefits and prorate all the benefits established under the law to fully exhaust the fixed budget. Such a process has been successfully implemented in both Bosnian entities and was already implemented in Kosovo in 2007 when only 70 percent of the value of benefits was paid.

Priority Actions in Pensions:

Protect Current System and Resist Pressures to Increase Generosity of System

30. **The pension system as it currently stands represents a reasonably optimal mix of providing a minimum subsistence level to all elderly, irrespective of contributor status.**¹³ It is important to maintain these features given the high degree of informality in the labor markets and a defined contribution savings-oriented system designed to provide additional benefits to current workers when they retire. The poverty assessment completed by the World Bank in 2007 shows that the first component of the pension system has had an important role in reducing both extreme poverty and absolute poverty, even more than the means-tested social assistance

¹³ The pension program in Kosovo provides benefits to all individuals at the age of 65 and above, irrespective of previous contribution history, at the current level of Euro 40 per month. This benefit, which has been fixed since 2005, is provided to 128,000 people. In addition, formal sector workers and their employers aged 55 and younger in 2002 are required to contribute 5 percent of wage each to an individual account with the Kosovo Pension Savings Trust (KPST), an autonomous public entity which manages retirement savings by investing the money with internationally recruited asset managers and provides payments either by lump sum or as periodic withdrawals when they retire or become disabled. Beginning in 2008, the government decided to acknowledge those who had contributed to the former Yugoslavian pension system by providing 75 per month instead of the €40 to those who could prove that they had contributed 15 years or more under the former system. The Government is still accepting applications for this increased pension, but estimates that only 35,000 of the total beneficiaries will qualify on the basis that there were 33,800 old age pensioners in 1998 and that 1,700 applications were still being processed. Until March 2008, 26,767 applications have been received for the increased benefit, with 21,000 of them already certified for payment in April 2008.

program. The second component of the pension system is designed to provide additional future benefits to current workers without imposing further liabilities on the Government and with appropriately low contribution rates, given the high rate of unemployment in the economy.

31. **Nevertheless, the Government continues to face political pressure from the current elderly to return to the more generous, but unaffordable, pension system of the former Yugoslavia.** All of the countries of the former Yugoslavia with the exception of Slovenia have substantially altered their inherited pension systems because the inherited system was inherently unaffordable. But the Kosovo pensioners and government have made repeated attempts to reintroduce major elements of the former system, while ironically the other countries are pushing to undertake reforms moving toward the existing Kosovo system. The original basic pension law dictated that the pension would be inflation indexed. This policy has never been followed and as indicated earlier, the basic pension remained at €40 per month since 2005. The recommendations are that the Government increases the basic pension in line with the accumulated inflation since 2005 for all those who are not receiving the increased basic pension which the Government has been providing for those with 15 years of verifiable contributions to the former Yugoslav system and that this be financed out of the budget. The Ministry of Finance & Economy (MFE) has already included the additional expenditure for inflation indexation in the MTEF. It is recommended that the Government should wait to allow these changes to be absorbed before embarking on any further changes to the pension system. The Government needs to be particularly cautious about not raising social contributions which will contribute to increasing the already high unemployment rate. The Government also needs to protect the mandatory pension contributions which are invested by KPST as agreed in the “Comprehensive proposal for the Kosovo Status Settlement”.

32. **Kosovo would also benefit from increasing its knowledge base on international experience and technical assistance in the area of pensions.** The Bank has sponsored a pension reform workshop, bringing in policymakers in neighboring countries so that the Kosovo policymakers can begin to absorb the lessons already learned by their neighbors. The Bank will continue to engage with Kosovo policymakers as their pension policy evolves as well as to assist with improved administration of the existing system.

C. HUMAN CAPITAL DEVELOPMENT

33. There is ample room for donor support (both financial and technical) for human capital development in Kosovo. In education, priority actions include: strengthening the institutional framework, improving access to secondary school (including removing demand-side constraints), strengthening teacher quality, teacher training and incentives for performance, supporting the expansion and improvement of higher education via improved financing mechanisms and strengthening quality assurance, and developing a policy and organizational framework for lifelong learning. In health, priority actions include: improving the quality of care, strengthening planning for public investments, improving productivity in public hospitals and health centers, developing management capacity in health care and pharmaceutical management, implementing health financing reforms, and improving the stewardship functions of the Ministry of Health (MOH).

Priority Actions for Education: Strengthening Institutional Framework, Expanding Access, and Improving Teacher Training and Incentives

34. **As Kosovo enters into a new face of development and integration into Europe, building the skills of young people for work and life will be crucial for poverty reduction, economic growth as well as peace and stability.** Improving the skills of young people for work and life also involves meeting the growing demand for post-basic skills and lifelong learning by providing a diverse, flexible and relevant system of learning opportunities in upper secondary, technical/vocational education, higher education and post-school training. Although the most important cause of joblessness is currently the lack of labor demand, the lack of relevant skills (to labor market needs) limits the ability of many people to get productive employment and to perform well the tasks required by employers (skills mismatch). Although Kosovo is still far from being a skill-intensive economy, there are already signs that the demand for skills is increasing and the nature of the skills demanded is changing towards more general skills that allow workers (and firms) to ‘survive’ and quickly adapt to changes in demand. But the supply of skills (produced by the education and training system) has not responded to these changes in demand. As the economy develops, and skills and knowledge become more important, the quality and relevance of skills produced by the education and training system will become an even more important driver of economic growth.

35. **The government has indeed identified education as one of the three key areas for economic and social development—and reflected that in the MTEF, and has articulated this strategic focus into clear and coherent sector development plans.** Notably, the government has produced two sound strategic plans for education (pre-university education 2007-2017 and higher education 2005-2015). These sector strategies provide an important foundation for potentially supporting the education sector via a Sector-Wide Approach (SWAp), which has many advantages for donor coordination. A recent report commissioned jointly by the Government and the donor group in education and funded by the Swedish Government provides an assessment the two sector strategies in the context of moving towards a SWAp (the SWAp report).¹⁴ The report recommends combining the sector strategies around overarching themes such as social inclusion and lifelong learning. This strategy document would in addition (i) include currently marginalized areas (preschool education, vocational training, science and technology, and non-formal education); (ii) specify priorities; (iii) elaborate on the management, implementation and monitoring of the master plan; (iv) elaborate on the roles and responsibilities of different administrative levels; and (v) tie overall financing of the education sector to the MTEF.

36. **Within this sector strategy and context, the main areas to strengthen the education sector in Kosovo are:**

- **Strengthening the Institutional Foundations of the Education System.** A first priority area for the sector is to establish the institutional foundation of the education system in which municipalities will have the primary responsibility for the delivery of pre-university education. This involves developing the legal framework that defines the roles and

¹⁴ International Swedish Institute for Public Administration and Ministry of Education, Science and Technology (2008). Assessment of the sector strategies.

responsibilities of different administrative levels for the different levels of education. In line with the settlement agreement, the Parliament recently passed the fiscal decentralization law, which includes general guidelines on how to determine the education grant to municipalities for schools. The municipal education law, which defines the competencies of municipalities in pre-university education, has been drafted and is currently being discussed in the assembly. A natural follow up to the new fiscal decentralization law is the design and implementation of a new funding formula for education grants to municipalities that better reflects the needs of schools, including vocational schools. The design this formula should incorporate the views and input of key stakeholders, including the Ministry of Education, Science & Technology (MEST), the MFE, and the Ministry of Local Government and Municipalities. A working group has just been set up for that purpose.¹⁵

- **Providing access to schooling.** Kosovo still requires new school construction, based upon professional school mapping, to take account of the sizable movement of population during the years of instability and the fact that quadruple shift schools exist in some urban areas. Quadruple shift schools need to be reformed into double shift schools through the expansion of the network on a strategic basis.
- **Removing demand-side constraints to secondary attendance.** The significantly higher dropout rates among the poor suggests that part of the problem lies in the lack of affordability of secondary school among poor families (beyond tuition, which is free). The effect of low affordability on the demand for education at the lower secondary level can be addressed through needs-based social assistance grants, such as CCTs. As discussed in paragraph 26, CCT have the dual goal of reducing current poverty (by providing transfers to poor families) and reducing future poverty through improved human capital (by conditioning benefits on human capital investments). The basic idea behind a CCT would be to provide a cash transfer to adolescents in poor families (or adolescents with characteristics that make them more likely to discontinue secondary schooling) conditional on attending secondary school.
- **Strengthening Teacher Training and Incentives.** Without teachers who are motivated and well-prepared, reforms to improve the quality and relevance of curricula are unlikely to be successful. The successful implementation of the new curricula will require appropriate pre- and in-service training, particularly training in student-centered methods. This will require systematizing in-service teacher training in Kosovo by (i) developing an accreditation system of training institutions and programs; (ii) preparing and disseminating a training catalogue; and (iii) developing a model for school-based professional development. The large number of teachers who are not qualified (3,900 teachers in pre-university education or about 18 percent of the total), low relative teacher salaries (about two thirds of average net earnings in the economy), and the fact that all teachers within a given education level are paid the same regardless of qualifications, experience and performance has generated a lot of dissatisfaction and concern for teacher quality and motivation. Monetary incentives, well-designed and well-implemented, can motivate teachers and make them accountable for performance. The system should use teacher performance as a key criterion for promotion. The system should be consistent with: (i) the objective of attracting and keeping well-qualified teachers that

¹⁵ Many of the activities outlined in this section are being supported by the World Bank under the Institutional Development for Education Project.

work to their potential; (ii) the fiscal envelop for teacher salaries; (iii) the implementation capacity of the MEST; and, (iv) the support from teachers. This process will require the certification of all teachers and increased recurrent budget allocations to provide for the incentive payments and will therefore need to be consistent with the MTEF.

- **Supporting the necessary expansion and improvement of higher education** via the introduction of an alternative (to tuition fees) supply-side financing mechanism for higher education institutions that are efficiency-enhancing, such as competitive funding and performance-based funding, as well as stronger quality assurance. This requires a feasibility study to identify which mechanism or combination of mechanism is best suited for Kosovo.
- **Developing a policy and organizational framework for post-school learning opportunities** with clear links to the formal school system and informed by the demands from the labor market and society. Strengthening the connection between school and work involves establishing partnerships with local employers to provide work-based learning opportunities through, for example, internships. Work-based opportunities are very limited in Kosovo even in vocational education, where the 2006 law envisages in-company training. In addition, links between higher education institutions and employers need to be strengthened.

Priority Actions for Health: Strengthening Quality, Service Delivery, and Planning and Management in the Sector
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37. **The health sector needs strengthening on the financing and delivery sides to better respond to the health needs of the population.** The financial sustainability of the health sector is affected on the revenue side by fragmented risk-pooling and the absence of purchasing mechanisms that would set financial incentives to providers to improve efficient provision of care. On the service delivery side, it is hampered by inefficiencies in pharmaceutical procurement and prescriptions, low productivity of health staff, and insufficient quality of care.

38. **To improve access to better quality care, efficiency in service delivery and financial management, several key areas will need attention as part of an overall health reform strategy.** There is a need to change the way health facilities are financed and managed, the institutional and organizational framework needs to be set up to move from the current fragmented to a single risk-pool. The current input-based hospital payment system sets incentives for providers to increase the number of beds and staff, and should be changed to reward better quality and efficiency. At the same time the providers need to be able to respond to the new financial incentives and improve productivity and quality of care, which requires legal changes in health management.. Improving the pharmaceutical procurement system, quality of care and allocation of human resources across facilities are key issues in improving the availability of quality care. There is a need for standardized accounting systems in all health facilities, and information on service use and outcomes in all health facilities. Information should be used in sector analysis to monitor and adjust health sector reforms. Inefficient revenue collection in health facilities is indicating problems related to informal payments and a lack of financial control in the health sector.

39. To improve the performance of the health sector, substantial and coordinated investment is needed. A three-pillar approach is suggested, focusing on improving the: (i) provision; (ii) financing; and (iii) management of health care, as further described in more detailed policy notes and studies:

Improve the provision of health care

- **Improve the quality of care.** Preliminary findings from the Master-plan Project point to wide variations in quality in terms of infrastructure and general cleanliness in healthcare facilities, with a significant percentage being at the lower end of the quality spectrum. It is in this type of environment that hospital acquired infections flourish, with patients with chronic diseases and those requiring frequent procedures, such as hemodialysis, being particularly vulnerable. The establishment of an adequate maintenance budget and associated policies and procedures to ensure structural quality is crucial. Major investment in the quality of basic health care is needed to improve health outcomes, reduce infant and child mortality and prevent and treat communicable diseases such as tuberculosis, as well as frequent diseases such as diabetes. Kosovo needs support in developing, implementing and managing an accreditation system to ensure quality of care in public and private facilities.
- **Capital investment should be based on a Master Plan (see Annex III).** While there is new construction underway in health facilities, these investments appear to be disconnected from any plan to assign staff to the facility, and organize funding for the maintenance of the new facilities. As a result, new health buildings are empty and not being used as they have no staff and maintenance budget, which will lead to the same maintenance problems as in all other buildings (e.g. drainage, sanitary facilities,). There is wide diversity of equipment in health facilities from various donors, including from multiple manufacturers and different models and age of equipment, which makes it difficult and expensive to keep infrastructure and equipment properly maintained. While some equipment is also overused, there is a high number of non-functioning or non-repairable equipment in many facilities. Some equipments lack reagents, contrast, and other consumables. A number of new equipment has never been installed or operated for various reasons, including the lack of reagents, or of professional staff trained in operating modern technology. Any future capital investment in health facilities needs to be based on the Master Plan. The availability of staffing, equipment and maintenance budgets are prerequisites for investments to start. Investment in equipment has to follow recommendations from the Master Plan, and ensure that the necessary maintenance budget and operational conditions are fulfilled, including staff trained.
- **Productivity in public hospitals and health centers must be improved.** In 2006, the visit rate for all outpatient care was 1.9 visits per capita. In Europe, only Albania reports a lower visit rate. Hospitals are also underutilized. Although Kosovo reports the lowest bed density in Europe, the five regional hospitals report very low bed occupancy rates, ranging from a low of 41 percent in Vushtrri to an average of 65 percent in the other four hospitals. Improving productivity requires adjusting human capacity in health facilities based on a human resource strategy and redirecting financial and other resources to increase productivity and the quality of services provided.

Reform health financing and provider payment

- **Implement health financing reforms and a purchaser-provider split (see Annex IV).** The Government plans to implement health financing reforms and create a single insurer who is also the purchasing/risk-pooling agent that receives funds from the general budget from the MFE and contracts selectively with public and private providers at all levels of care (primary, secondary and tertiary). These reforms include substantial changes including in the governance and financing framework and provider payment reforms, as described in the World Bank health financing study. Implement health financing reforms following the recommendations presented in the health financing study.

Strengthen management and stewardship in health

- **Management capacity in health sector needs to be developed.** In Kosovo, the financing and provision of hospital care is managed centrally; while primary health care (PHC) centers are owned and managed by the municipalities. Health facility managers have little authority over spending, staff levels, staff selection and performance, and capital; they are unable to take steps that would improve efficiency of care. Strong policy and institutional reforms to strengthen public sector financial management, administrative capacity, and mechanisms for ensuring accountability are fundamental. Management reforms are needed in all public health facilities to provide greater managerial autonomy for providers to improve efficiency and quality of care. This may include changing the legal and organization form of hospitals and outpatient centers to attract professional managers.
- **Pharmaceutical management and procurement needs to be strengthened.** Shortages of essential drugs and other supplies are widespread. Theoretically, in public facilities, essential drugs are provided to patients free of charge. But, public funding is not sufficient to provide access to essential drugs for the entire population. As a result, at least 80 percent of Kosovo's pharmaceutical market is financed by patients' out-of-pocket payments. The public pharmaceutical procurement system is struggling to overcome management and governance deficiencies, including the allocation of pharmaceuticals from the central level to health facilities. Shortages of drugs and supplies in public health facilities cause patients to seek care in the private sector and purchase drugs in pharmacies. A major effort is needed to strengthen the pharmaceutical system, starting with a system to monitor the use of drugs in health facilities. Data on drug prices, availability, and utilization should be collected and then used to do pharmaceutical procurement, price-setting, and prevention of drug stock-outs in health facilities.
- **The stewardship function of the Ministry of Health (MOH) needs to be strengthened.** The MOH needs to assume its policymaking and stewardship role, and implement reforms in quality assurance in the provision of care, organization of health facility management, and management of resources including staffing and pharmaceuticals. Provide an experienced policy advisor to the Minister of Health on stewardship and policy advice, to support implementation of reforms.

D. CONCLUSIONS

40. The policy issues addressed in this paper represent a huge challenge for Kosovo and must be undertaken in a carefully sequenced time-bound manner, within a very constrained fiscal environment. The top priorities for the short-term (next 6 months) and medium-term (next 3 years) may be highlighted as follows:

In the short-term

- Prepare urgently a white-paper on social policy which will develop options (with full fiscal cost calculations) identifying the trade-offs (e.g. negative labor market consequences of transfer programs);
- Refrain from any policy actions which would further constrain the growth of the formal labor market (this particularly implies avoiding raising payroll taxes);
- Freeze any further increase to pensions, war veterans or any other social benefits until the whitepaper on social policy ;
- Terminate the passage of any new labor legislation which will over-regulate the labor market or generate pressures for increased public expenditures (e.g. through the impact on public sector wages);
- Develop the health Master Plan;
- Initiate the process of certification of teachers so as to link pay more fully to competency and performance; and
- Pilot test labor intensive public works program.

In the medium-term

- Improve the database on outcomes in the human development sectors as the basis for planning – having a national census is a critical element in this+;
- Develop improved mechanisms of M&E and an M&E culture within the human development sectors in particular;
- Pass sound basic legislation on labor;
- Expand and strengthen targeted social assistance programs (considering the potential for a Conditional Cash Transfers (CCT) to reduce secondary school drop-out rate for the poorest students and to facilitate employment entry for poor youth;
- Undertake labor market reforms that create an improved environment for future job creation and productivity growth;

- Re-orientate public expenditures to make them more labor intensive and expand labor intensive public works if the pilots are assessed to be effective;
- Implement the health Master Plan;
- Improve teacher training;
- Expand the school network based upon sound school-mapping; and
- Coordinate donors around the implementation of the government's whitepaper on social policy.

Pension Policy Reform for Kosovo

Current pension policy in Kosovo consists of a basic pension provided to all citizens aged 65 and above and a fully funded, defined contribution pension for all those under the age of 55 when the policy was enacted. There is a perception in Kosovo that the current system is not European and should be radically changed to become more like other European systems. In fact, European systems are changing to become more like what Kosovo already has because their traditional European systems are not fiscally sustainable and do not serve the needs of the 21st century workforce. Nevertheless, there is a generation in Kosovo which has not been treated fairly. However, any attempt to remedy this treatment will create at least as much new inequity as it eliminates and will undermine the sound foundations for a future pension system. **The Government is strongly urged to reconsider proposals to radically alter the nature of the current system.**

History. Pension policy in Kosovo needs to be viewed within its historic context. Workers and retirees in Kosovo initially participated in the former Yugoslav pension system. This system was a defined benefit system where retirees received benefits based on the number of years of service as well as on the basis of the salaries they had earned while working. The pensions were fully indexed to wage growth so that the living standards of the elderly kept par with the living standards of the working age population. It was a generous system with men able to receive 85 percent of wage after 40 years of contributions and women the same with even fewer years of contributions. Retirement ages were young, at 58 for men and 53 for women. In addition, special privileges were granted for a wide range of workers, allowing them to retire both with more generous benefits and earlier than the specified retirement age. The system was financed on a pay-as-you-go basis (PAYG), where contributions from current workers, set at 31 percent of wage, were used to finance pension benefits for beneficiaries.

Even without the special circumstances which affected Kosovo, the system was completely unsustainable. The average western European system provides a benefit rate of about 60 percent or less after 40 years of contribution, not the 85 percent promised by the former Yugoslav system. In addition, the experience of all the transition countries is that while full labor force participation and contribution for both men and women during working ages was previously the norm, resulting in high rates of pension receipt among today's elderly, the transition to a true market economy meant that some workers became unemployed, others chose not to work, and others began working in the informal sector which does not pay contributions. As a result, the number of people paying contributions fell to roughly half the previous number of contributors while the number of beneficiaries rose due to both the aging of the population as well as the use of the pension system as an unemployment insurance system for workers who found themselves displaced. Pension systems in all transition countries faced financial crises, and all transition countries enacted significant reforms, substantially altering the provision of pensions and reducing the benefit provided.

Prior to the breakup of the socialist system, the Kosovo pension system faced additional unique challenges. Beginning in 1989, the Milosevic regime began to force many Albanian

Kosovars out of their formal sector jobs, significantly reducing the number of Kosovars who paid contributions to the pension system, which was now administered by Belgrade. From the beginning of armed conflict, Belgrade also discontinued making pension payments to Kosovar pensioners.

After the conflict, one of the many issues faced by the Kosovo authorities together with UNMIK was the issue of how to protect current pensioners and how to set up a pension system for the future, given limited budgetary resources and incomplete records of past contribution history.

Current Pension System. Given limited resources, the decision was made to provide all elderly aged 65 and above with a monthly benefit equal to the extreme poverty line to be financed out of the budget. This was managed by the pension department within the Ministry of Labor and Social Welfare. In addition, workers below the age of 55 were required to put 10 percent of their wage, half paid by the employer and half by the employee, into a new institution, the Kosovo Pension Savings Trust (KPST), which is a relatively autonomous government entity, regulated by the Central Bank. The contributions are collected by the tax authorities and transferred to KPST. These contributions are deposited in individual accounts and invested on behalf of the workers. Interest earned on contributions is attributed to the individual accounts. When the worker reaches retirement age, the total amount in the individual account, contribution plus interest, becomes available to finance retirement for the worker. Older workers could contribute to the KPST on a voluntary basis, but it was considered unfair to require them to contribute as they were unlikely to build up a sizable pool of savings before retirement, particularly since part of the contribution financed the administrative costs of the system.

Unlike the original, defined benefit pay as you go financed pension system of the former Yugoslavia, this second component known as a fully funded, defined contribution system generates no unsustainable fiscal liabilities for the Government as people receive only the value of their own accumulated assets and remains viable despite the future aging of the population which renders pay as you go financed systems nonviable in the longer term.

Basic Pension. The basic pension was initially set at €28 per month in 2002. It was supposed to be indexed annually to inflation according to the law. The level was raised to €40 per month in 2005 and has remained at that level since then. While inflation has been relatively low since, the recent global acceleration in food and fuel prices suggests that leaving this basic pension unchanged going forward may result in severe hardship to pensioners. This basic pension is currently being paid to 128,000 people and costs the Government approximately €65 million per year. There is an issue with these pensions in that the pension department does not receive automatic notification when a pensioner dies and continues to pay the pension until a person is officially determined to have died. At least 20 percent of deaths remain unreported despite the department's attempts to require pensioners to appear in person at least twice per year and to verify continued longevity through home visits.

In addition to the basic pension, immediately before elections in October 2007, the Government passed an administrative instruction allowing all those who had 15 years of contribution under the old system to receive €75 monthly rather than the €40 basic pension, as a

way of responding to complaints by pensioners regarding a violation of their rights. A budgetary cost of €14.5 million has been designated to cover this additional benefit on the basis of an estimate of 35,000 old age pensioners with contribution history in the old system. The 35,000 number is likely an underestimate since it is based on the number of old age pensioners existing in 1998 plus the number of applications being processed at the time. Nowhere in the world has the number of pensioners remained constant since 1998. With population aging worldwide as well as increased longevity, the number of pensioners inevitably rises, but given the particular experiences of Kosovo, the 35,000 number is at least a starting estimate. In April 2008, 21,000 people received the higher pensions. However, the pension applications are still being processed. They were divided into categories, the first being all those who were already pensioners in 1998, the second being those who can present work booklets proving that they had contributed for 15 years and for whom the work history can be verified, and the third being those who are either missing their work booklets or for whom the work history cannot be verified. So far, the first category is completely processed and receiving the higher pension, part of the second category has been processed, and the third has not begun. Given the war history of Kosovo, the vast majority of people may be in category 3 with either the work booklets lost in the upheaval of war or the corroborating enterprise having been shut down or disappeared or the work history having taken place outside of the Kosovo borders and unable to be verified. Decisions will have to be made on how to address these people fairly, particularly since these are the people who may have suffered the most during the war.

It should be noted that pensioners are also eligible for the substantial benefits provided by the War Veterans' Department which provides benefits to those who were injured during the war or to the families, including parents, of those who were killed either as participants in the conflict itself or as civilians. These benefits have no impact on the pension status of the individuals or families.

Funded, Defined Contribution Pension. The funded pillar in Kosovo, managed by KPST, had 259,390 contributors at the end of 2007 with assets under management of €79.6 million. Benefits were paid to 2,822 individuals totaling €1.8 million. Its quarter of a million contributors are estimated to represent about 31 percent of the employed in Kosovo, with the remaining employed working in the informal sector, although precise numbers are difficult to obtain in Kosovo given the lack of a census. About 10 percent of the money collected each year is not immediately allocated to participant accounts due to information problems with the information provided by the tax authorities, but the KPST is working to resolve this problem and to allocate this money to the individual accounts.

KPST is managed by a seven member Board of Governors, four of whom must have a minimum of 10 years professional experience in finance, economic, or pension studies. In addition to the governing board, the KPST is regulated by the Central Bank. KPST is allowed to invest in 5 classes of international instruments and 4 classes of domestic instruments.¹⁶ Of the

¹⁶ Permissible international investments include bank accounts and deposits in banks regulated by a banking authority in an OECD country, securities issues by OECD governments, securities issued by local governments of OECD countries if guaranteed by national government, securities registered with an OECD securities market regulator and which are listed on a stock exchange regulated by an OECD securities market regulator, and mutual and investment funds established in OECD countries. Domestic instruments are limited to bank accounts and

domestic instruments, only certificates of deposit currently exist in Kosovo. As a result all of the money is held abroad, with 60 percent invested in stocks and 35 percent in bonds. Administrative costs of 1 percent of assets were typically charged each account, although the administrative charges have been reduced to 0.9 percent of assets in 2008. These costs cover the fees paid to asset managers, staff salaries and equipment and the cost of annually printing and mailing out statements to each contributor.

Overall, KPST has performed well. KPST was listed among the top three small European pension funds by the well-known trade publication, *Investment and Pensions Europe*.

Evaluation of Current System. Before proceeding to an evaluation of the current pension system, it is worth reviewing the objectives of a pension system. A pension system is supposed to (a) alleviate poverty in old age and (b) replace labor income when an individual is no longer able to work due to old age, disability, or death.

The poverty alleviation objective is well addressed in the Kosovo pension system through the basic pension. The level of the basic pension was initially set at the extreme poverty line and then not indexed with inflation as it should have been. This allows all elderly in Kosovo to have a minimum living standard, although slightly below the extreme poverty line due to lack of indexation. Without the basic pension, if the estimates of the number of contributory pensioners are correct, then 73 percent of the elderly would be without any means for poverty alleviation in old age. The percentage of covered elderly is higher in most of the neighboring countries which currently do not have a basic pension, but as in the case of Kosovo, only 30-50 percent of the current working age population in these countries is actually working in a job which pays contributions. As a result, in 20 years in these countries too, some 50-70 percent of the population will reach retirement age without any provision for old age security unless a basic pension like Kosovo's is implemented. Ideally if the budget permitted, the level of the basic pension could rise to the poverty line, which includes non-food necessities as well as the food requirements which are already captured in the extreme poverty line and would be systematically indexed to inflation.

Almost all OECD countries provide some type of basic pension, either on a means tested basis or universally provided to all citizens of a particular age, as shown in Table 1. Most OECD countries have a high percentage of the labor force paying contributions and use means-tested benefits to provide poverty-alleviation. But some have a universal old age benefit like Kosovo's. The level of the poverty alleviation benefit, whether means-tested or universal, is not much higher than Kosovo's relative to the country's own average wage, as shown in the latter two columns of Table 1. Means-tested benefits have the advantage of providing government-financed old age benefits only to those in need and thus are less costly than universal benefits, but universal benefits avoid the disincentives to participate in a contributory system by being provided irrespective of contribution history and avoid the additional cost and hassle of means testing. As a crude rule of thumb, countries which can only collect contributions from less than half of the labor force are better served by universal pensions while countries able to collect

deposits with banks licensed by the Central Bank of Kosovo, securities by the Kosovo Government, corporate securities registered with the securities regulator of Kosovo and listed on a licensed exchange and mutual and investment funds regulated by a competent authority in Kosovo.

contributions from the majority of the labor force are better served by means-tested pensions for the basic needs of the remaining population. Since Kosovo finds itself with a coverage rate around 31 percent, it would fall in the universal category, suggesting that while the level of the pension and its indexation may need adjusting, the policy is appropriate for the current coverage level in Kosovo.

For the objective of providing replacement income for future workers, Kosovo currently has the funded, defined contribution system managed by KPST. In an ideal world, people would be left to choose how to allocate consumption over their lifetimes with savings during the working years financing retirement in years when they have become too old to work. However, people behave myopically and do not save enough and then lobby governments to support them when they are old and have no other means.

Country	Targeted as % of avg earnings	Basic as % of avg earnings
Australia	23	
Austria	37	
Belgium	23	
Canada	16	14
Denmark	17	17
Finland	21	
France	31	
Germany	24	
Greece	12	
Iceland	25	
Ireland	28	31
Italy	22	
Japan		19
Korea		30
Luxembourg	36	12
Netherlands	34	34
New Zealand		38
Norway	33	18
Portugal	20	
Spain	-	-
Sweden	34	
Switzerland	26	
UK	26	20
USA	20	

Table 1: Targeted and Basic Pensions in OECD Countries¹⁷

¹⁷ Source: Whitehouse, *Pensions Panorama*, World Bank, 2007.

Governments have addressed both of these problems by requiring workers to save a percentage of their incomes in financial institutions, but historically, when these programs first began, secure long term financial institutions did not exist to intermediate funds over the lifetime of a worker. Governments took on the role of intermediating savings across generations, but at a time when there were few elderly and many workers. While initially they collected contributions and saved them on behalf of workers, they quickly realized that the expenditures each year were far lower than revenues and rather than save the difference, the Government could spend it, either by borrowing it explicitly, or by just agreeing to fund any future deficit in the pension fund. But as populations have aged worldwide, pension systems financed in this pay as you go method can afford to pay much lower pensions to current generations than they paid in the past. And now that financial institutions are more secure and financial instruments more varied, governments have once more turned to having individuals save for themselves in the form of funded, defined contribution pensions. Ten countries in Latin America and fourteen among the central and eastern European countries have already introduced funded components to their pension systems as shown in Table 2 below.¹⁸ Western European and non-European OECD countries are also moving to add funded components to their pension systems and many have already done so, given that they also face aging problems.

Country	Starting Date	First (or Zero) Pillar	Size of second pillar as percent of payroll	Projected pension fund assets in 2020 as percent of GDP	Share of workforce in funded pillar in 2003/6	Switching strategy to new system
Hungary Operating	January 1998	PAYG DB	8 percent	32 percent	45 percent	Mandatory new entrants Voluntary others
Kazakhstan Operating	January 1998	Guaranteed Minimum	10 percent	35 percent	82 percent	Mandatory
Poland Operating	January 1999	PAYG DC/NDC	7.3 percent	34 percent	70 percent	Mandatory <30, Voluntary 30–50
Latvia Operating	July 2001 (NDC January 1996)	PAYG DC/NDC	4 percent growing to 10 percent by 2010	25-30 percent	72 percent	Mandatory <30, Voluntary 30–50
Croatia Operating	January 2002	PAYG DB	5 percent	25 –30 percent	60–70 percent	Mandatory <40, Voluntary 40–50
Bulgaria Operating	January 2002	PAYG DB	5 percent		70 percent	Mandatory <42
Estonia Operating	July 2002	PAYG DB	6 percent	20 percent	75 percent	Voluntary (opt-out +2 percent)
Russia Operating	January 2002	PAYG DC/NDC	4 percent (6 percent in 2008)	n.a.	33 percent	Mandatory <50
Kosovo Operating	January 2002	Universal/min. consumption basket level	10 percent	8 percent (end-2006)	30 percent	Mandatory
Lithuania Operating	January 2004	PAYG DB	5.5 percent	35-40 percent	55 percent	Voluntary

¹⁸ The Latin American countries include Mexico, Costa Rica, El Salvador, Dominican Republic, Colombia, Bolivia, Peru, Chile, Argentina, and Uruguay. In the Europe and central Asia region, the fourteen countries include Estonia, Latvia, Lithuania, Poland, Hungary, Slovak Republic, Croatia, FYR Macedonia, Bulgaria, Romania, Kazakhstan, Russia, and Ukraine, in addition to Kosovo.

Slovakia Operating	January 2005	PAYG DB	9 percent	20 percent	73 percent	Mandatory new entrants
FYR Macedonia Operating	January 2006	PAYG DB	7.12 percent	26 percent	25 percent	Mandatory new entrants
Romania Operating	Registration completed Contributions beginning with June 2008	PAYG DB	2 percent in 2008 growing gradually to 6 percent until 2016	9 percent	65 percent (from the total of PAYG)	Mandatory <35 Voluntary 36-45
Ukraine Partially legislated	January 2009	PAYG DB	2 percent growing to 7 percent	n.a.	Zero	Mandatory new entrants

Table 2: Characteristics of Pension Reforms in Transition Economies Moving to a Multipillar System¹⁹

The funded component of the Kosovo pension system provides the Kosovo workers exactly the same type of social security that other workers throughout Europe and the OECD are currently being provided, the requirement that they save for their own retirement because this is the only fiscally sustainable way of providing old age support as populations age. A system which could pay good benefits when there were 10 workers supporting each pensioner so that 10 percent of wage paid by each worker will amount to a pension of 100 percent of average wage for the pensioner, will not function as well when there are two or fewer workers per pensioner, which is the future that all countries face. The fiscally sustainable pension will amount to less than 20 percent of wage under this case.

However, the big difference between the Kosovo policy and that of other countries is the treatment of current pensioners and soon to be pensioners. In most cases, when funded pensions were introduced, current pensioners continued to receive the same level of benefits they had been receiving, but usually with reduced indexation. Workers who had contributed in the old system received some prorated benefit when they retired, prorated by the years of contribution in the old system, but these benefits were not typically the same as the original benefits. The whole system was typically shrunk, with lower benefits, lower indexation, and higher retirement ages for those not yet retired. These prorated benefits, typically called acquired rights, were partially paid by the Government as workers began to put part or all of their and their employer's contributions into the new funded system. This Government financing of the pension system deficit caused by the move of contributions to individual accounts is known as the transition deficit. This payment of replacement pensions from general revenue temporarily skewed the income distribution, with government resources paying higher pensions for higher income retirees, but given the long run advantages of the reforms, this temporary regressive measure was considered one of the acceptable costs of the reform. In most of central Europe with the exception of Kazakhstan, some component of a traditional defined benefit system was retained alongside the funded system. This was retained for three reasons: (1) the need for poverty alleviation in the absence of a basic pension, (2) desire to diversify sources of old age security so as not to fully depend on either public or private sources, and (3) the need to help finance the transition deficit. If the full contribution of workers is put in individual accounts, then the Government has a high transition deficit to finance. If only a portion of the contribution is put into the individual accounts, then

¹⁹ Updated table from Holzmann et al. *Old Age Income Support in the 21st Century*, World Bank, 2005.

the Government still receives some revenue from current workers to help finance current pensioners, lowering the cost of the transition deficit. But current workers will not pay contributions to the public system unless they are promised some benefits, and as a result, some downsized version of the public defined benefit system remains. However, what future generations will receive from the public system will be dramatically smaller than what even the currently reduced pensioners receive.

In Kosovo the contributions and rights of current and soon to be pensioners, accumulated under the former Yugoslav system, were not preserved. All pensioners were given the €40 pension regardless of contribution history, due to both budgetary constraints and lack of contribution records. While some contribution records in Kosovo were copied and kept before the administration was moved to Belgrade, previously Kosovar workers worked all over the former Yugoslavia. The contributions of workers were paid and recorded in the geographical area, not only where they worked, but where the enterprise for which they worked was headquartered. Thus, if a Croat firm had a factory in Kosovo which employed Kosovar workers, the contributions were paid in Croatia and the records kept there. As a result, what is available to the Kosovo authorities for verification is only a fraction of the total work histories of Kosovo citizens. The measures undertaken beginning in January 2008 where individuals with contribution history are provided €75 instead of the 40 make the distinction between those who contributed and those who did not, but continue to blur the distinction between those who contributed based on high salaries and those who contributed based on low salaries. But as noted earlier, given the lack of complete records, even whether someone contributed or not is difficult to verify. Differentiating the pension further by level of past contribution becomes even more difficult since the past salaries are in the old Yugoslav Dinar and would need to be converted in some way to euros. Even countries like Slovenia who did this conversion more than 15 years ago when the Yugoslav Dinar was still intact found many difficulties in this conversion. In countries like Albania where full records exist, past salaries are impossible to convert into pensions today and a decision by the Council of Ministers in 1994 assigned wages to be used for particular occupations in pension calculations for past work. And finally, even if all the verifying records could be found and all the conversion could take place, the workers who lost their formal sector jobs in 1989 and were not able to contribute in a formal system also need to be provided some resources since their unemployment and lack of contribution during this period was not their own doing.

Whatever method would have been chosen to accommodate former contributors would have resulted in unfairness to one group or another. Given the limited budget resources available, the Government chose to provide equal amounts of poverty relief for all elderly. However, the combination of the low level of the pension, the lack of distinction between those who contributed and those who did not, and the lack of differentiation between those with high and low salaries has made the current pension policy highly unpopular, particularly among pensioners, who believe that some form of the old system with its generous benefits can be re-initiated.

Current Reform Proposals. The Ministry of Labor and Social Welfare has reacted to the unpopularity of the current pension system by proposals to further differentiate pensions among current beneficiaries, using educational level to serve as a proxy for former salaries and

contributions. Since the €75 pension for all contributors has already gone into effect, this increased differentiation will result in a further rise in average pensions. They have also proposed instituting a payroll tax of 10 percent of wage on all formal sector workers as a means of paying for this increased differentiation.

There are a number of problems with these proposals. On financing, one argument being advanced is that the Government is currently spending €80 million on basic plus contributory pensions. If there were a labor tax instead, the government could save this amount of budget to be spent on true poverty relief. However, a quick look at the numbers shows that there are 259,000 contributors and 128,000 pensioners, roughly 2 contributors per pensioner. If each worker paid 10 percent of wage, each pensioner could receive 20 percent of average wage. With average wage around €200 per month, this would amount to a pension of €40 per month which is what most are already getting and less than what a few are receiving. So while government expenditure is saved, the pension level is lower on average than what pensioners are receiving and complaining about today. If further differentiation were required, some would have to receive well below the benefit being received today which is already slightly below the extreme poverty line.

If, on the other hand, the contribution revenue would be exclusively relegated to only the 35,000 persons assumed to have contributory history, pensions might be able to rise to as much as €150 per month only for the 35,000 persons, but the remainder would have to rely on government financing, which would still cost at least €50 million. Those with verifiable contribution history are people who had relatively high education and good jobs during the Yugoslav period, suffered less displacement and were able to keep their work booklets, and worked at enterprises which still exist, suggesting that they also are more likely to have retained their jobs immediately after the war if they were not already retired. So such a policy would reward those pensioners who are already less likely to be poor and would leave the vast majority of pensioners no better off than before and with a sizable government expenditure still to be financed out of general revenue for those with no contribution history.

Looking to the future, if a labor tax is instituted to finance today's pensioners, who finances the pensions for today's workers when they reach retirement age? In the future, the number of contributors will barely be two or three times the number of workers. Affordable pensions will then be only around two or three times the average contribution, which would yield a pension of €40-60 in today's terms. This proposal then would reduce future pensions for the 260,000 contributors of today and at best raise pensions for 35,000 people today. While these 35,000 pensioners may be most vocal today, trading in the future of 260,000 people to benefit only 35,000 today, does not seem like a worthwhile trade.

Finally, there are issues with imposing a payroll tax. Under the "Comprehensive proposal for the Kosovo Status Settlement", the status of KPST as the institution which manages the funded, defined contribution pension system is protected. Imposing a 10 percent additional labor tax means raising the overall labor tax to 20 percent for pensions alone in an economy with a huge unemployment rate. Raising labor costs would restrict employment and make finding jobs that much harder for those who are currently unemployed. Getting these workers employed would provide the best social protection for the people of Kosovo. Making the KPST

contributions voluntary, as has been suggested by some in the Ministry of Labor and Social Welfare, would be seen by the donor community as a clear violation of the “Comprehensive proposal for the Kosovo Status Settlement” and would risk losing donor support.

Thus, the current proposals would have the following impact:

- *Raise the level of pensions for a minority of pensioners while leaving the more vulnerable pensioners with the same level of pension and with few cost savings to the Government;*
- *Create further inequities by differentiating not just on the basis of actual contribution history, but on the basis of availability of contribution evidence;*
- *Reduce the future pension for current contributors at the expense of the higher pensions for a few of today’s pensioners; and*
- *Raise labor costs, resulting in less employment for today’s workers, or risk losing donor support.*

Alternative Reform Option. Given that none of these outcomes are desirable, a less costly approach might be to **keep the contributory pensions at €75 temporarily until it is clear exactly how many people are involved.** The distinction between who contributed and who did not is already being made, but the differentiation regarding how much each person contributed is not. The tricky issues of how to treat those who have lost their work booklets in the upheaval of war or for whom no corroborating evidence exists because the enterprises which used to employ them are now closed or located outside of Kosovo have yet to be resolved. The unresolved cases not only raise considerable uncertainty regarding the future costs of the current policy, but also are likely to involve individuals who have suffered the most harm including those who were forced to move at short notice during the war or for whom jobs were not available after the war. Before changing policy, it would be best to fully implement this policy to determine the costs going forward.

For those ineligible for the increase on the basis of previous contributions, it would be appropriate to **raise the €40 level by at least the accumulated inflation since 2005.** Eventually as budgetary resources improve, raising the level of the basic pension to the full poverty level rather than only to the extreme poverty line may also be feasible and desirable. However, in this case the Government needs to balance the needs of these pensioners against the needs of others in the economy to determine whether raising the level of the basic pension is the most beneficial use of the money from the perspective of the overall society.

The Government needs to accompany these measures with a public education campaign which explains to workers and retirees what the new system is and why these decisions were taken. Retirees, in particular, need to understand that the former Yugoslav system was not sustainable, and that retirees and workers throughout the former Yugoslav system have experienced reduced benefits, and while some aspects of their situation may be unique, the Kosovo Government is building an old age system which will protect generations of future Kosovo workers without experiencing the financial sustainability problems that are currently affecting pensioners and workers in many other European countries.

With regards to the funded pillar, the current arrangement with KPST appears to be working well. The fund is generating reasonable rates of return with moderately low administrative costs. The international experience tends to be that privately managed pension funds manage reserves better than publicly managed institutions, and that competition among pension funds should result in better rates of return and lower administrative costs for participants. While the former is borne out by international experience, the latter is not necessarily. The problem with public management of pension reserves is typically twofold. First, the type of expertise needed for a pension fund manager is not typically found in government, but rather among top financial institutions such as those found in New York or London. Secondly, there can be a conflict of interest where pension fund reserves are directed toward investments which benefit politically powerful constituencies or toward investments in government instruments, which finance government expenditures which also provide benefits to the politically powerful. As a result, these publicly managed pension funds often do not perform well in their core function which is to protect the investments of pension fund participants and to provide them the best value for their money. However, there are good examples where public institutions are managing pension fund reserves well, such as in Ireland, Canada, Sweden, and Japan. The variance in performance of public vs. private institutions depends heavily on governance issues of the public pension funds, which have been relatively recently addressed in these four countries.

Thus far, governance issues have not been a large factor in the performance of KPST because its board consists of well-known international professionals from the pension field who lay down performance benchmarks which are then met by external fund managers, with all the investment currently taking place abroad. As the composition of the board changes and KPST begins to invest domestically, potential conflicts of interest could arise, and the regulator will need to be watchful for any evidence of these conflicts.

On the other side, the potential benefits of private sector competition in the management of pension fund reserves have not always materialized in countries which have multiple private sector funds. There are large economies of scale in pension fund management and in small markets, even under competition, there are rarely more than 2 or 3 pension funds. A well-regulated monopoly may perform better than competition between a very small number of funds. The international evidence also shows that under competition, private pension funds tend to spend large sums on advertising and sales costs, resulting in often higher administrative costs rather than lower. The regulator would also have to devote considerable resources to regulating the competition between firms as well as to regulating the individual firms. Given the small size of the market and limited regulatory capacity, for the time being, the optimal strategy would be to leave KPST as it is, with the view that as the market grows and develops, KPST could be privatized and opened to competition. However, should adverse governance issues arise, the speed of privatization and competition may need to be accelerated.

Another issue which may need to be addressed in the future is the level of the contribution rate. As countries face population aging, typically the contribution rate for old age security will need to be around 15 percent. Currently, Kosovo's 10 percent contribution rate may be on the low side. However, given the very high unemployment rate, it would be

unadvisable to raise the contribution rate at this time. But as the labor market develops, eventually a higher contribution rate may be required.

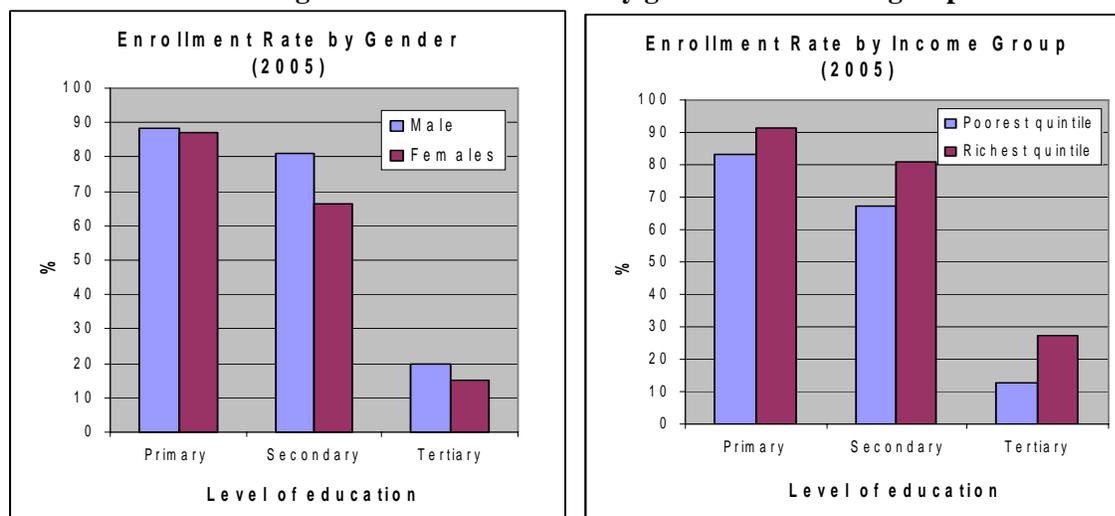
Conclusions. While marginal changes may be required to the current pension policy in Kosovo, the Kosovo authorities are advised not to make large changes to the current system. Indexing pensions to accommodate price increases since 2005 and the recent rise in food prices is clearly beneficial. But the structure of the current pension system is sound. For the future, the pension system provides both poverty relief for the elderly and a mechanism to provide a minimal level of replacement income without creating unsustainable fiscal liabilities for the Government. The current pensioners and soon to be pensioners are indeed receiving less than they had expected, but any attempt to provide better benefits for those with verifiable work histories will create more inequity for those with unverifiable work histories and will prevent the development of a sustainable pension system for current and future workers.

SUPPORTING THE DEVELOPMENT OF EDUCATION IN KOSOVO: KEY CHALLENGES AND POLICY OPTIONS

After an initial post-conflict acceleration in 2000, economic growth has weakened. Unemployment rates are the highest in Europe, particularly among youth (44 percent), and 44 percent of the population is below the poverty line. As Kosovo enters into a new phase of development and integration into Europe, building the skills of young people for work and life will be crucial for poverty reduction, economic growth as well as peace and stability. The government has indeed identified education as one of the key drivers of economic growth and social development—and reflected that in the medium-term expenditure framework (MTEF), and has articulated this strategic focus into clear and coherent sector development plans.

Improving the skills of young people for work and life involves improving educational preparation for adolescence by providing quality basic education for all. The transition to secondary school remains a barrier for many children, particularly girls and the poor—81 percent of boys/children in the richest quintile are enrolled in secondary education compared to 67 percent of children in the poorest quintile and 66 percent of girls (Figure 1). Although the data on student learning is very limited, a recent pilot assessment of children in grade 5 shows poor learning outcomes, particularly in mathematics—only 18 percent of students reached the 40 percent passing benchmark.

Figure 1 Enrollment ratio by gender and income groups



Source: World Bank (2007). Kosovo Poverty Assessment.

Improving the skills of young people for work and life also involves meeting the growing demand for post-basic skills and lifelong learning by providing diverse, flexible and relevant system of learning opportunities in post-basic levels of education. Although the most important cause of joblessness is currently the lack of labor demand, the lack of relevant skills (to labor market needs) limits the ability of many people to get productive employment and to perform

well the tasks required by employers (skills mismatch). Although Kosovo is still far from being a skill-intensive economy, there are already signs that the demand for skills is increasing and the nature of the skills demanded is changing towards more general skills that allow workers (and firms) to 'survive' and quickly adapt to changes in demand. But the supply of skills (produced by the education and training system) has not responded to these changes in demand. As the economy develops, and skills and knowledge become more important, the quality and relevance of skills produced by the education and training system will become an even more important driver of economic growth. This has become clear in the more advanced reformers in Central and Eastern Europe.

The rest of the note describes the key issues to be addressed to improve the skills of young people for work and life, highlights the policy response to these issues so far and identifies the policy gaps to address the issues, and how development partners can support these policy reform efforts.

1. Moving towards a strategic vision of the education sector as a whole

Moving forward requires at a minimum a clear strategic vision of the sector as a whole (and articulated into an education sector master plan), and a consistent MTEF. The government has produced two good strategic plans for education (pre-university education 2007-2017 and higher education 2005-2015). These documents already include, with some level of generality, most of the policy priorities presented in this note. There is also a MTEF for 2008-2010 that is currently being revised for 2009-2011.

A recent report commissioned by the donor group in education and funded by the Swiss Government provides an assessment the two sector strategies in the context of moving towards a Sector Wide Approach for donor investments (the SWAP report).²⁰ The report recommends combining the sector strategies into a single one around overarching themes such as inclusion and lifelong learning. This strategy document would in addition (i) include currently marginalized areas (preschool education, vocational training, science and technology, and non-formal education); (ii) specify priorities; (iii) elaborate on the management, implementation and monitoring of the master plan; (iv) elaborate on the roles and responsibilities of different administrative levels; and (v) tie overall financing of the education sector to the MTEF.

Having a unified strategic plan along the lines suggested by the SWAP report would provide the platform for a SWAP, with donors aligning around it. One key recommendation of the report is the need for the strategic document to include the necessary provisions and architecture to facilitate a smooth implementation, adequate monitoring and evaluation of progress (based on a well-defined M&E matrix) and, ultimately, improved sector performance. The most important problem with the two sector strategies is that no implementation plan has been developed. This is because of the lack of capacity to move from strategies to actions (based on annual action plans). Significant investments are needed to increase the capacity to plan, implement, monitor and evaluate at the Ministry of Education, Science and Technology (MEST). This is particularly the case if education sector is to move to a full SWAP with direct budget

²⁰ International Swedish Institute for Public Administration and Ministry of Education, Science and Technology (2008). *Assessment of the sector strategies*.

support from donors. So in addition to developing a unified sector strategy, MEST should start working on (a) preparation of a plan for capacity building, (b) preparation of annual action plans (including sources of domestic and external financing), and (c) conducting annual reviews of progress in the implementation of the sector strategy.

The strategic plan should include a detailed costing of development efforts and components. The total cost of carrying out the two strategies is estimated to be €389 million, or an annual cost of €78 million over the next five years. This suggests that the funding gap for the next five years over and above the MTEF to be financed through donations and international support is €82 million, or around €16 per year. This gap is over and above the MTEF because the implementation of the two strategies requires resources over and above the MTEF sector ceiling for education. However, the MTEF also has a financing gap, and the education sector's share of it is €89 million over the period 2008-2010 (€62 per year). So the total gap to be financed by donors is €78 million annually for 2008-2010.

Development partners are actively organized around a donor coordination mechanism and committed to supporting the development of education in Kosovo. Key development partners that are either active or planning to be actively involved in the education sector include ADA, CIDA, Danida, EC, EAR, ETF, GTZ, Finish Support to the development of Education in Kosovo (FSDEK), OSCE, SDC, SIDA, UNICEF, USAID and the World Bank. In addition, many NGOs (e.g. Swiss Contact) are involved in the education sector either as donors or implementing agencies. The new World Bank-funded Institutional Development Education Project (IDEP) supports the two education strategies by (i) supporting the components already included in these strategies; (ii) moving from components to actions through time-bound action planning; and (iii) building the capacity to plan, implement, monitor and evaluate at MEST.

2. Strengthening the organization and financing of the education system

A first priority area for the sector is to establish the institutional foundation of the education system in light of Kosovo's decentralization process in which municipalities will have the primary responsibility for the delivery of pre-university education. This involves developing the legal framework that defines the roles and responsibilities of different administrative levels for the different levels of education.

In line with the settlement agreement, the Parliament recently passed the fiscal decentralization law, which includes general guidelines on how to determine the education grant to municipalities for schools. The municipal education law, which defines the competencies of municipalities in pre-university education, has been drafted and is currently being discussed.

A natural follow up to the new fiscal decentralization law is the design and implementation of a new funding formula for education grants to municipalities that better reflects the needs of schools, including vocational schools. The design of this formula should incorporate the views and input of key stakeholders, including MEST, Ministry of Economy and Finance, Ministry of Local Government and Municipalities. A working group has just been set up for that purpose.

This working group should also consider the development and implementation on a pilot basis of alternative funding formulas for municipalities to allocate resources down to schools. The current practice of not following any objective criteria for allocating resources across schools has potentially negative consequences on equity and efficiency of school financing, nor does it serve any particular educational goal at the national and local levels. Municipalities should exercise their competency by clearly defining their goals (e.g. more weight given to small rural schools) and reflect that in the formula for allocation resources down to schools. It is also important that these municipal funding formulas are aligned with the formula for education grants to municipalities in order to keep the necessary consistency between national and local level objectives. This can be achieved by readjusting the parameters of the main formula for education grants to fit the interests of municipal governments.

Improving the funding formula is only part of the school financing reform. The team believes that consideration should also be given to the role of schools in planning and managing resources. Increased school autonomy requires building the management capacity at the school level. Efforts should also be made to build the management capacity at the municipal level.

Financing the necessary expansion and improvement of higher education will require reaching out to the private sector through public-private partnership, but also the introduction of alternative (to tuition fees) supply-side financing mechanism for higher education institutions that are efficiency-enhancing, such as competitive funding and performance-based funding. This requires a feasibility study to identify which mechanism or combination of mechanism is best suited for Kosovo.

3. Expanding access to education opportunities

In terms of physical access, there are 70 schools in Kosovo (about 10 percent of the total) operating in three shifts, and the majority of the remaining schools operate in two shifts. Given the young population and relatively high population growth rate, the demand for school space will continue to increase, and investments needs are expected to be significant in the short to medium run. In fact, 80 percent of the cost of implementing the pre-university strategy for 2007-2012 is accounted for by capital investments (mainly school construction). In the MTEF, the budget for capital investments goes up from €16.3 million in 2007 to €43 million in 2010.

This large school construction program should be guided by tools to be able to make good school investment decisions (through an evidence-based school facility investment plan), and to build schools that meet adequate learning environment and energy-efficiency standards. The work to develop these tools should start as soon as possible so as to have the maximum impact on the school construction program. This large school construction program also requires strengthening the capacity for contracting and quality control at MEST.

Building schools can meet increases in demand for school space, but these investments will not necessarily increase school participation or reduce inequality. As mentioned earlier, the transition to secondary school remains a barrier for many children, particularly girls and the poor. This could be due to several demand-side factors—low levels of preparedness, the perceived irrelevance of secondary schooling, and the high direct and indirect costs—and

because of low physical access to secondary schools. A study is urgently needed to identify the underlying factors of school dropout as well as the feasibility of alternative policies and programs to reduce it, particularly among the girls and the poor.

Although poverty can be correlated with other factors, the significantly higher dropout rates among the poor suggests that part of the problem lies in the lack of affordability of secondary school among poor families (beyond tuition, which is free). Credit constraints on the demand for education at the lower secondary level can be addressed through needs-based grants, such as conditional cash transfers (CCT), given the externalities associated with basic education. CCT have the dual goal of reducing current poverty (by providing transfers to poor families) and reducing future poverty through improved human capital (by conditioning benefits on human capital investments). A forthcoming study finds that a transfer targeted to poor unemployed youth would have a large impact on poverty in the short run, particularly extreme poverty.²¹ The basic idea behind a CCT would be to provide a cash transfer to adolescents in poor families (or adolescents with characteristics that make them more likely to not go to secondary school) conditional on attending secondary school. CCTs have an excellent track record of raising attendance in poor rural communities across the world and also in SEE (Turkey).

In designing demand-side financing mechanisms such as CCT, it is also important to think of the education system as a whole—to avoid imbalances and bottlenecks. For example, the success of *Oportunidades* in Mexico and *Bolsa Familia* in Brazil increases the pressure on the post-compulsory system. It is thus necessary to anticipate the rising number of individuals completing basic education and willing to study further. To help design the most appropriate mechanism for each education level, it is important to take into account unit costs, the relationship between private and social benefits, and the choices that individuals face as they go through the different levels of the education system. This is why international experience shows that a combination of well-targeted grants, loans, and savings schemes can be used to alleviate credit constraints at upper secondary and tertiary levels, and thus help to generate the resources to expand post-compulsory education (including vocational education) while ensuring equitable access.

The idea behind the savings scheme would be for CCT beneficiaries to also accumulate points from the last year of lower secondary until the end of secondary school. Credit points are converted into a savings account and deposited into individual accounts, which beneficiaries can tap for further study or to start a business if they complete upper secondary.

The higher cost of tertiary education and the higher ratio of social to private benefits make student loans more appropriate, but well-designed loans are hard to implement in low-income countries. Income-contingent loans are superior to conventional loans. By deferring payments until individuals start working and reach a certain income, they have lower default rates, promote more equitable access and loan repayment, and increase efficiency by addressing uncertainty about future earnings and facilitating consumption smoothing. However, they are hard to implement and may not be a realistic option for Kosovo yet.

²¹ World Bank (forthcoming). *Youth in Jeopardy: Being young, unemployed and poor in Kosovo*.

As young people mature, they take more control of their education, but some constraints prevent them from benefiting from their learning opportunities. They lack the motivation to learn as well as the information on post-primary education opportunities and the labor market and have limited access to resources. They also face competing options to schooling—work and family—as well as alternative learning options. Helping young people make better education choices requires better decision making skills (section 4.1) and incentives to exert effort such as the savings scheme outlined above. Financial incentives have already been addressed above.

The third set of policies to improve education decisions aims at providing better information about learning options and work possibilities. School-based career guidance services—which provide information on education and job market opportunities as well as counseling—are one such policy. These services are not systematically available in Kosovo. There is, however, a commitment by MEST, the Ministry of labor and Social Welfare (MLSW), and the Ministry of Culture, Youth and Sports (MCYS) to embed career guidance services across the education and training system. This year, career guidance services are being piloted in grade nine.

4. Building the institutions to improve the quality and relevance of education

The low learning achievement in Kosovo shows that schools are failing to prepare young people for work and life. Improving the quality and relevance of education involves making the school curricula more relevant by teaching practical subjects, thinking skills and behavioral skills as well as blending the academic and vocational curricula in upper secondary. Education must, in addition, strengthen the connection between school and the local economy to facilitate the school-to-work transition and boost economic development. The success of these reforms relies on motivated and well-prepared teachers, and schools accountable for student learning. With external assistance, some of the regulations, frameworks and institutions needed to support these reforms are already in place in Kosovo. But even when present, implementing these regulations and frameworks and making institutions operational is proving challenging.

4.1. Improving the quality and relevance of school curricula

Teaching relevant skills in general education. To improve the quality of basic education, and thus the educational preparation of adolescents, the school curricula needs to be tailored towards the teaching of basic skills needed for further learning, work, and life, including numeracy and literacy and basic levels of behavioral skills such as perseverance, self-discipline, and self-confidence. This curriculum reform needs to be accompanied by teacher training in student-centered methods. To improve the relevance of post-basic education to labor market needs, and thus meet the growing demand for post-basic skills, the curriculum and teaching need to be reformed towards the provision of post-basic skills, including thinking skills, higher order behavioral skills (decision-making skills, teamwork, the ability to negotiate conflict and manage risks), specific knowledge applied to real-life situations (e.g. practical subjects like science, technology, economics, and foreign languages) and vocational skills.

The National Curriculum Framework (NCF) for preschool, primary and secondary education emphasizes many of the skills outlined above, but it yet to be finalized and

implemented. The successful implementation of the new curricula will require appropriate pre- and in-service training as well as support to schools. The review and quality improvement of the curricula will require regular student assessment. A new body, the Council for Curriculum, Textbook and Assessment (CCTA), is expected to oversee curricula design, implementation and review. It should be supported in doing this job efficiently and effectively.

Blending the academic and vocational curricula in upper secondary. General and vocational curricula should be more integrated, as the skills demanded by young people and labor markets go beyond and cut across the traditional division between general and vocational curricula. Postponing vocational education until upper secondary and connecting it to higher education are two ways to integrate vocational and general education. Kosovo has done this recently.

Also needed is greater blending of content, bringing more vocational content into the general curriculum and more vocationally relevant academic subjects (science, mathematics, language) into the vocational curriculum. Improving the relevance of technical and vocational education and training (TVET) also requires developing a national qualifications framework that sets the standards for different fields in accordance with demands from employers, and then tests and certifies these standards. The curriculum is then designed to meet these standards.

The 2006 Law on Vocational Education and Training was aimed at gearing TVET to the needs of the labor market and the standards of the European Union (EU). A new body, the Council for Vocational Education and Training (CVET) was established with participation of several ministries, unions, business associations and NGOs to develop and review standards. To date, however, this body has had very little impact on developing and effectively introducing new standards. Thus the enacted curriculum has changed very little. Although vocational education account for more than half of the students at the upper secondary level, it is still perceived as an option for low performers that do not make into upper secondary school rather than as a real alternative to general education. The government is working on a national qualifications framework and legislation compatible with the European Qualifications Framework, but the process has been slow. A National Qualifications Authority is to be set up under the new legislation. In the meantime, certification is provided by each education and training institution under different standards.

Making higher education the engine of the knowledge economy. Higher education institutions do not serve the needs of the economy. All higher education institutions are governed by the Law on Higher Education in Kosovo. The main public higher education institution, the University of Prishtina (UP), continues to coexist and operate independently from the other public institutions, the University of North Mitrovica. Since the end of the conflict in 1999, UP has made important qualitative changes with the adoption of the Bologna Declaration and the ongoing implementation of European Credit Transfer System (ECTS). But progress has been slow. The contents and teaching of higher education programs, have changed very little, making the knowledge and the skills gained in higher education of little relevance to the needs of economy. University of Prishtina is still far from providing recognizable undergraduate and graduate degrees that make its students employable and internationally competitive. Quality control over institutions and new programs is weak. There are 33 private higher education

institutions operating under a license issued by MEST. Most of these institutions, however, have not been subject to any quality assurance.

Proving learning opportunity after school. Because changes in demand require constant skills upgrading, opportunities for lifelong learning opportunities beyond school need to be provided. These opportunities should also be available to those people who are already out of school and do not have the basic skills to be productively employed (second chance learning opportunities)—about 58 percent of women aged 25-54 have less than secondary education. This system of post-school learning opportunities needs to reflect the diversity of needs of the people demanding these opportunities in terms of, for example, skills attainment. Skills training needs to be more holistic and also include life skills, which are essential for succeeding in today's labor market. Lifelong learning opportunities also need to accommodate the work responsibilities of these people by, for example, designing training in modules and offering alternative schedules. At the moment, there are short training courses (3 months) for unemployed young people (25 years of age or younger) but coverage is very limited and programs and certificates are not even recognized.

A policy and organizational framework for post-school learning opportunities—clearly linked to the formal school system and informed by the demands from the labor market and society—needs to be developed. Addressing diversity, while scaling up enrollments, is greatly facilitated by reaching out to the private sector and NGOs. The role of government in these programs should be that of standard setter, regulator, and funding agent, and less that of provider. Finally, people in need of second chance learning opportunities also face other constraints to find productive employment, including their limited access to information and resources, and so learning opportunities need to be integrated with other services, such as employment and entrepreneurship services as well as grants and loans for education and training.

Strengthening the connection between school and work involves establishing partnerships with local employers to provide work-based learning opportunities through, for example, internships. Work-based opportunities are very limited in Kosovo even in vocational education, where the 2006 law envisages in-company training. In addition, universities and research institutes can collaborate with local industry through joint projects and technology transfers and establish firms (spin-offs) to commercialize their inventions. At the moment higher education institutions do very little research.

Reaching out to the private sector with quality assurance. Expanding and improving post-basic education and lifelong learning opportunities can be greatly facilitated by reaching out to the private sector through public-private partnerships (PPPs). The private sector plays a very small role as provider of education and training in Kosovo and partnerships with the public sector are almost non-existent. But the increased financing role of the private sector needs to be combined by a solid quality assurance of institutions and programs. At the moment there is no quality assurance mechanism on any part of the education and training system. This is a major concern in higher education with the proliferation of low quality private higher education institutions. An accreditation system would set quality standards lower at the entry point (licensing) to give new institutions the chance to grow, and later make the standards more stringent (accreditation) for both public and private institutions.

A new body, the Kosovo Accreditation Agency (KAA), was established to implement such a system for higher education. But so far it has not lived up to its mandate, which is why the government has just recently commissioned a review of private higher education institutions in Kosovo. The findings will be reviewed by KAA and will be crucial in the process of accreditation of private higher education institutions, expected to start this summer.

4.2. Motivating and preparing teachers

Without teachers who are motivated and well-prepared, reforms to improve the quality and relevance of curricula are unlikely to be successful. As noted earlier, the successful implementation of the new curricula will require appropriate pre-and in-service training, particularly training in student-centered methods. This will require systematizing in-service teacher training in Kosovo by (i) developing an accreditation system of training institutions and programs; (ii) preparing and disseminating a training catalogue; and (iii) developing a model for school-based professional development. These tasks would be overseen by a National Teacher Education Board (NETB), which would also assist in the development of long-term strategies for teacher professional development.

The large number of teachers who are not qualified (3,900 teachers in pre-university education or about 18 percent of the total), low relative teacher salaries (about two thirds of average net earnings in the economy), and the fact that all teachers within a given education level are paid the same regardless of qualifications, experience and performance has generated a lot of dissatisfaction and concern for teacher motivation. Monetary incentives, well-designed and well-implemented, can motivate teachers and make them accountable for performance.

A working group has been working on a teacher licensing and salary differentiation system since 2004. The current proposal defines the standard to become a teacher, creates an initial differentiation among qualified teachers by pre-service qualifications, as well as a vertical differentiation according to experience, accumulation in-service, and some consideration for teacher performance.

The system should use teacher performance as a key criterion for promotion. The system should be consistent with: (i) the objective of attracting and keeping well-qualified teachers that work to their potential; (ii) the fiscal envelop for teacher salaries; (iii) the implementation capacity of MEST; and (iv) the support from teachers.

To be able to design and implement this system it is necessary to systematize in-service teacher training along the lines suggested above, as well as to develop clear criteria and the necessary infrastructure to introduce a system of promotions based on teacher performance (which requires defining teaching standards, standards for good teaching and the tools to measure teacher performance, e.g. portfolios, self-evaluation, peer-to peer evaluation, student achievement etc.) The idea would be for the NETB to oversee the design and implementation of this system. Designing and implementing a system consistent with (i) through (iv) will therefore take some time. But the pressure is on the government to do something about teacher licensing

soon. To accommodate this, the government could follow a 2-level parallel strategy: (1) develop the system Kosovo eventually wants to have; and (2) introduce a basic system in the short run

The basic system has to be implementable (including consistency with current legislation on civil servant pay and data availability) and have the financial resources to back it up. The simplest model would just distinguish between qualified and unqualified teachers, and establishing the path for qualified teachers to become qualified. An alternative model would further introduce differentiation by pre-service qualification. School funding for recurrent costs should incorporate and be adjusted to the new teacher licensing system. As more complicated teacher licensing systems are introduced, it is essential to collect information from teachers on pre-service qualifications, years of experience, in-service training etc. This information can be made available through the Education Management Information System (EMIS) or a future HRMIS for civil servants.

4.3. Strengthening monitoring and evaluation

A strong monitoring and evaluation (M&E) system in education is an essential tool for education policy and planning and for holding teachers and schools accountable for performance (through accreditation, funding allocation, or performance-based pay).

The current M&E system does not produce the information needed to review progress in the implementation of MEST's education strategies in terms of education outcomes: student numbers (e.g. enrollment rates in primary education), student flows (e.g. primary completion rate) and student learning (e.g. numeracy and literacy skills among primary school graduates). While there is some knowledge on student number and flows, there is absolutely no knowledge about the most important outcome of the education system: student learning. This information is important for education policy and planning but also for public accountability purposes.

The software for EMIS has been developed and installed in 70 percent of schools but it is currently not operational. Making EMIS operational in all schools in the country requires (a) providing new computers for schools where new computers are needed to run EMIS; (b) installing EMIS in those computers and ensure proper management of EMIS at the central level; and (c) providing training on data entry, education indicators, and data analysis and reporting for school, municipal and MEST administrators.

Consideration will have to be given to how the data will be transferred from schools to municipalities and from those to MEST. The current EMIS has all the relevant information on schools, students and teachers, which can be adapted as needed (e.g. in the context of the teacher licensing system or the reform of the school financing system.) Also, the capability of EMIS to produce school report cards should be encouraged at the school level as a tool to increase accountability of schools by communities. As with student learning, the weakest point of this type of information system tends to be the dissemination of information to policy makers at MEST. So the training at the central level (department of planning) should also focus on how to translate EMIS data into policy relevant information. EMIS dataset can also be integrated with other school level data (e.g. school facility data and student assessment data).

A sustainable national assessment system needs to be developed to collect regular data on student learning for the purpose of feeding this information into education policy and planning as well as disseminating it to the public in general. The assessment unit in MEST will be the 'implementing agency' for test design, as well as collecting, analyzing, reporting and disseminating information on student learning. The assessment unit has already piloted a grade 5 assessment in numeracy and Albanian language. The weak points of the assessment unit are test design, and the analysis and dissemination of data. The work of the assessment unit needs to be supported by providing equipment, software, technical assistance and capacity building. It is very important that there is a focal point at MEST to provide guidance to the work of the assessment unit and to ensure the information on student learning feeds into education policy and planning.

Key decisions for the design of the assessment system include (i) the grades at which students are to be tested, (ii) the skills on which they are to be tested and (iii) whether to collect the information from a (representative) sample of students or from all students in the tested grades (census-based). MEST should also consider the assessment to be census-based because the information can then be used to evaluate the performance of schools and teachers and to tie financial incentives to that performance, thus serving as an accountability tool. In the context of the discussion on teacher licensing, a possible tool for evaluating teacher performance is student learning. Such a system has been successfully implemented in other countries.

RECONFIGURING THE HEALTH SECTOR: DEVELOPING A MASTER PLAN FOR KOSOVO

THE CHALLENGE

Developing an efficient, effective and equitable health system is a challenge for any country, but particularly for countries in transition, which have inherited inefficient health service delivery systems characterized by excess capacity and duplicative infrastructure. Although Kosovo has the lowest hospital bed density in Europe, the health infrastructure is underutilized and not currently meeting the health needs of the population.

The challenge is to assess the current service delivery network and propose an alternative structure that is tailored to the demographic and health needs of the population, as well as sustainable within current resource constraints. The purpose of this document is to describe the development of a **Master Plan**, which will describe the future health services delivery network and the approach that will be used to achieve it.

To develop a master plan for the health delivery system, it is crucial to understand how various health care services are delivered at the national and regional levels through the existing network of providers and facilities. Complex factors must be taken into consideration, such as stakeholder interests at the provider level, the settlement level, the municipal level, as well as the political context and available resources. Developing and adjusting a provider network takes time, so the network must be designed not only for the population and their health needs of today, but also for the needs in the medium and longer term. It is crucial that the process of developing the optimal network is comprehensive, consultative, transparent, and based on agreed parameters. The final Master Plan must provide clear direction to planners and investors, and of course be sustainable.

THE CONTEXT

Macroeconomic and fiscal context

The health service delivery network that is proposed in the Master Plan must be appropriate for the current and projected level of resources in the health system over the medium to longer term. Since 2006, Kosovo's economy has been growing moderately, and government revenues have been increasing. The budget has been kept in balance through strict limits on recurrent expenditures and under-spending on capital. The macroeconomic performance and ongoing fiscal constraints substantially limit the potential for additional revenue for the health system.

- **With limited additional revenue potential, it is essential to improve the efficiency and productivity of the health service delivery infrastructure.**

Socio-demographic context

There is lack of information on the population, health outcomes, including morbidity and mortality statistics that could be used for international comparison, to set priorities, and to monitor the outcomes of health reforms. Information that is available suggests that Kosovo has high infant and child mortality, increasing rates of tuberculosis, as well as the lowest life expectancy in the South Eastern Europe region (69 years). There are major concerns about quality of care in public health facilities.

- **Major investment in the quality of basic health care is needed to improve health outcomes, reduce infant and child mortality and prevent and treat communicable diseases such as tuberculosis, as well as frequent diseases such as diabetes.**

Current service delivery infrastructure and utilization

Kosovo is among the few health sectors that still have a Semashko health care model—the centrally planned National Health Service (NHS) model of the former Soviet Union. In Kosovo, the financing and provision of hospital care is managed centrally; while PHC centers are owned and managed by the municipalities. Health facility managers have little authority over spending, staff levels, staff selection and performance, and capital; they are unable to take steps that would improve efficiency of care.

- **The restructuring of the service delivery system should be accompanied by management reforms that provide greater managerial autonomy for providers to improve efficiency and quality of care.**

Kosovo’s PHC centers appear to be underutilized. In 2006, the visit rate for all outpatient care was 1.9 visits per capita. Of countries in the South Eastern Europe region, only Albania reports a lower visit rate. **Hospitals are also underutilized.** Although Kosovo reports the lowest bed density in Europe, the five regional hospitals report very low bed occupancy rates, ranging from a low of 41 percent in Vushtrri to an average of 65 percent in the other four hospitals. Low utilization rates in the public sector point to a significant demand for care by patients in the private sector and in neighboring countries including FYR Macedonia and Serbia, where they pay cash at the time of service use.

- **A restructured delivery system should focus on streamlining capacity and redirecting resources to increase the quality of services provided and ensure that patients seek care in the public system.**

THE PROCESS OF DEVELOPING THE MASTER PLAN

Understanding the current public sector health delivery network

The first task in developing the Master Plan is to understand in detail the current network of providers and facilities and how it operates. This involves a review of data available through the Ministry of Health, and site visits to health facilities to collect primary data critical to developing the Master Plan. Visiting facilities provides the opportunity to identify and

understand local issues and aspects of the environment that may be significant, and to gain an understanding of why a particular network configuration exists.

Required data includes, for example:

- Description of hospital staffing, beds by specialty, discharge numbers, average length of stay, bed occupancy rate, etc.;
- Description of the physical layout and condition of the facilities;
- Inventory, description, and status of key equipment;
- Description of the network of primary care providers;
- Description of the referral process; and
- Description of the surrounding private health care providers.

In addition, it is also necessary to obtain the details of the road infrastructure and transportation in order to understand access issues and to effectively plan the placement of the new provider network. Geographic Information System (GIS) can be a useful tool for describing the current network and its characteristics, such as the location of specialty departments or equipment, and time to reach providers for different types of care.

Understanding the current private sector configuration

The private sector is a significant provider of health care services in Kosovo, but the exact configuration of providers is not well understood. The network that will ultimately be suggested through the Master Plan needs to consider the services that are provided through the private sector, so the site visits will include visits to private sector providers. Data will be collected from relevant government departments overseeing the private sector, such as the business registration agency.

Understanding the current and future population and health needs

It is crucial in developing the Master Plan that the population served by the network is well understood. Much of this information is likely to be readily available, as such information is a core requirement for health sector investment.

Necessary information includes, for example:

- Location of the population by settlement;
- Age and gender distribution;
- Current morbidity and mortality rates and distribution;
- Ethnic/geographic issues that may impact of the configuration of the network;
- Socioeconomic status, including employment status;
- Any particular regional health issues;
- Past patterns of population change/migration;
- Predicted future population change/migration; and
- Estimates of future morbidity patterns.

CONTENT OF THE MASTER PLAN

Determining the planning parameters

It is critical that the parameters for determining the reconfiguration of the health services network are well defined and agreed upon by the key stakeholders. A series of expert groups is established as part of the Master Plan development process to discuss and ultimately agree on what those planning parameters should be. Individual expert groups will focus on the key sectors, such as primary care, secondary care and tertiary care. It is important that there is agreement on the planning parameters, to ensure agreement on the final network configuration.

Examples of planning parameters might include:

- Differences in health or economic status in different regions;
- Number of beds per population per specialty;
- Number of doctors per population per specialty;
- Number of nurses per population per specialty;
- Number of pharmacists per population;
- Average length of stay per bed type;
- Bed occupancy rate;
- Access time from population centers to nearest primary care facility;
- Access time from population centers to nearest secondary care specialty department; and
- Access times to specific technologies and specialties.

International comparison data may also be useful to assist the expert groups in selecting the parameters and in deciding on the possible target level for each parameter. The expert groups can also provide valuable input to the minimum equipment that should be in place for specific types of care. Consideration of the overall funding level that is available through the national health care system is an important factor, as is the quality of care that will be delivered through the system.

Identifying desirable changes in care delivery

The master plan will identify desired changes in service delivery that must be supported by the new network. For example, if there is a plan to shift services to primary care or expand day surgery, the new network should support these changes. The possibility of introducing new clinical networks in particular areas, such as mental health or oncology, also should be considered and factored into the network design, and any necessary investment in new types of facilities should be identified. The cost of such initiatives and the capacity of the existing facilities to undertake these types of change should be considered. These service delivery objectives should be discussed by appropriate policymakers and clinical expert groups.

The existence and likely impact of other health care initiatives also needs to be considered, as these can potentially change the requirements for the future network. Primary care initiatives, for example, that improve the quality of care and encourage primary care providers to become gatekeepers of care should result in fewer admissions to hospitals for

ambulatory care sensitive conditions. The projected reduction in the need for hospital care should be considered when defining future hospital capacity. Also, clarification of referrals between levels of care and the introduction of various programs, such as payment systems to encourage appropriate referrals will have an impact that needs to be considered in the network design. The potential impact of current and future health sector initiatives should be discussed within the expert groups. Different scenarios may need to be developed with varying assumptions about the impact of these various programs on service delivery needs.

Identifying the desired number of beds and staff at the national and regional level

Once the current and future health needs of the population are understood and the success of the various other healthcare initiatives considered, then the overall requirements for the network can be developed at both national and regional level.

Developing Network configuration options

At this point a series of scenarios can be developed to optimize the network in accordance with the planning parameters and projected impact of health sector initiatives. There may be a number of ways in which to achieve a similar outcome, so the expert groups may be presented with several options to discuss. Moving a specific department from one facility to another, for example, may improve access time for patients, but there may be other issues to consider, such as the capacity and cost for the facility to increase bed numbers.

The impact of changing particular features of a network can be subtle and difficult to visualize. The GIS approach can assist in demonstrating the impact of the new network configuration on the distribution of services and access time. For example, the impact that adding or removing a department at a regional hospital has on the access time for the local population can be shown to the expert group graphically through a GIS presentation.

Broader consultation

Once the expert groups have considered the alternatives and narrowed the options for the network configuration based on defined and agreed parameters, broader discussion is then necessary before a decision is made on the final network configuration.

Finalize the Master Plan

Following this further discussion, the Master Plan is then finalized and circulated. The plan will include a description of the optimum network(s), and suggested changes to the current network to achieve this. The implementation component should include a timeframe for these changes to take place and milestones. The Master Plan will also contain a monitoring and evaluation plan. The final Master Plan can then be used by the Government and donors to guide capital investment decisions in a rational, coordinated way; as well as investment decisions into medical equipment and high-cost medical technology.

KOSOVO HEALTH FINANCING POLICY NOTE

THE CHALLENGE

The government of Kosovo aims to strengthen the health system through health financing reforms and modernization of health care delivery. The **goals of health financing reforms** are to:

- Raise additional funds for the health sector;
- Create efficient risk pooling to avoid catastrophic health expenditures;
- Ensure equity in access to care; and
- Create incentives for providers through payment systems that reward performance improvement.

The main strategy for health financing reform is to **establish a single health insurance fund (HIF)** to pool government funds and pay for basic care delivered in public health facilities. The following government documents provide the legal basis for reform and guidance for implementation:

- **Kosovo Health Law No. 2004/4** provides the legal base for health financing reform, proposing to establish a single health insurance fund.
- The **Kosovo Health Strategy 2005-2015** is to guide reforms in financing and service provision.
- A **master plan** is being developed that describes the health provider network needed to meet the population's needs for the short, medium, and long term.

The challenge is to determine the structure, governance, sources of revenue, and other elements of the social health insurance (SHI) system that are appropriate for the macroeconomic and socio-demographic context, as well as the institutional, organizational, and existing social insurance context in Kosovo. The purpose of this document is to present different options for an insurance system, focusing on revenue collection and management, risk-pooling arrangements, purchasing, and the supportive regulatory and governance framework.

THE CONTEXT

Macroeconomic and fiscal context

Kosovo's macroeconomic and fiscal context will determine how much additional revenue potentially can be generated by new financing mechanisms. Since 2006, the economy has been growing moderately, and government revenues have been increasing. The budget has been kept in balance through strict limits on recurrent expenditures and under-spending on capital. The modest macroeconomic performance, the relatively low formal labor force participation (estimated at 52.3 percent), and ongoing fiscal constraints substantially limit the potential for additional revenue for the health system.

- **With limited additional revenue potential, it is essential to improve the efficiency of the existing public resources for the health system.**

Socio-demographic context

There is lack of information on the population, health outcomes, including morbidity and mortality statistics that could be used for international comparison, to set priorities, and to monitor the outcomes of health reforms. Information that is available suggests that Kosovo has high infant and child mortality, increasing rates of tuberculosis, as well as the lowest life expectancy in the South Eastern Europe region (69 years). Findings from the master plan raise concerns about quality of care in public health facilities.

- **Major investment in the quality of basic health care is needed to improve health outcomes.**
- **Investment in the collection and analysis in population, health statistics and performance data is needed to inform decisions on health spending and resource use, and to allow for monitoring and evaluation.**

Institutional and organizational context

Kosovo is among the few health sectors that still have a Semashko health care model—the centrally planned National Health Service (NHS) model of the former Soviet Union. Under this direct-provision model, the financing, risk pooling, and provision of health care is managed by the same organization. Health financing is simple disbursement of government budget funds to public health facilities. There is no opportunity for a purchasing agent to set financial incentives for providers to improve efficiency and quality of care. In addition, health facility managers have little authority over spending, staff levels, staff selection and performance. The lack of responsibility and accountability among facility managers negatively affects the delivery of health care.

- **Implementing a health insurance system will require separation of the financing from the service delivery function in the health care system.**
- **New purchasing arrangements will require health facility managers to have more authority over management decisions. Providers also must be kept accountable to the purchaser to provide high quality health care for the money they receive.**

Government health spending is about 3 percent of gross domestic product and 10 percent of government revenues. The current level of government spending covers about half of total health expenditures, while patients contribute the remaining half with out-of-pocket payments. Shortages of essential drugs and other supplies are reported to be widespread. At least 80 percent of Kosovo's pharmaceutical market is financed by out-of-pocket payments. The high levels of out-of-pocket payments mean that illness can be catastrophic, driving families into, or deeper into, poverty.

- **A new insurance system should provide financial risk protection for households by reducing out-of-pocket payments at the time of service delivery.**
- **Substantial investment in pharmaceutical procurement and provision is needed to ensure transparency and the availability of drugs in health facilities.**

Public primary health care (PHC) centers and hospitals are underutilized, so the productivity of physicians and hospital capital currently is very low. Low utilization rates in the public sector point to a significant demand in the private sector and in neighboring countries, including FYR Macedonia and Serbia. There is no accreditation system, however, to ensure the quality of all providers.

- **Provider payment systems used by the new purchaser in the health insurance system should be designed to reward increased productivity and quality of care.**
- **The MOH should invest in setting up an accreditation system for all providers. The insurer should only contract with accredited (public or private) providers.**

ELEMENTS OF A HEALTH INSURANCE SYSTEM: THE OPTIONS

Any health insurance system has five main elements: (1) revenue collection; (2) risk pooling; (3) benefits, eligibility and entitlement; (4) purchasing of services; and (5) governance structure. Kosovo will have to make decisions about the most appropriate options in each of these areas.

1. Revenue collection

Policy decision: Determine the appropriate mix of sources of revenue for the health sector

Objective: Adequate, stable, and sustainable level of financing for the health sector.

Options:

- Possible sources of revenue for the health sector are **general taxes, dedicated taxes** (social insurance contributions or earmarked income or sales taxes), **voluntary insurance premiums**, or **user charges** (formal and informal). **Most countries use a mixture of revenue sources.**
- **Dedicated taxes**
 - Dedicated taxes are independent of the annual budget process, so they are less vulnerable to political pressures. Dedicated taxes that are payroll taxes, however, are sensitive to changes in wages and unemployment. Payroll taxes are also difficult to collect when the informal labor market is significant.
 - 18 countries of the Europe/Central Asia (ECA) region have introduced payroll taxes as part of new SHI systems. The payroll taxes themselves have failed to increase revenues for the health sector due to:

- Weak tax collection systems and large informal economies;
- Ministries of finance have reduced general tax contributions to the health sector, so the payroll tax revenue has been a substitute rather than a new source of funds;
- Evasion of the payroll tax has been a problem because of weak collection mechanisms and lack of a clear link between contribution and benefits;
- High payroll tax rates discourage firms and workers from coming into the formal sector.

- **General tax revenues**

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- Despite the switch to payroll tax contributions in transition countries, general tax revenues continue to play a significant role in health care funding in many countries to reduce the negative impacts on the labor market of payroll taxes.
- There is a trend in Europe to reduce or eliminate payroll taxes and switch to a greater reliance on general tax revenues for financing SHI, such as in France. General tax revenues are also becoming a more important source of health care funds in some transition countries, as payroll taxes are being reduced in Albania, Croatia, Hungary, Kazakhstan, Armenia, and Georgia. Switzerland, for instance, never had payroll tax for health insurance.

- **Voluntary health insurance**

- There is very limited experience with voluntary health insurance (VHI) in the ECA region. Even in countries where VHI is most developed, such as France and Switzerland, VHI has only contributed at most 1 percent of GDP to the health sector.
- The market share of private insurance in transition countries has been limited by several factors: (i) insufficient number of high-quality provider networks to contract with; (ii) the SHI benefit package is not clearly defined; (iii) a tradition of informal payments at the point of service; (iv) limited capacity for regulation, management, and actuarial studies; and (v) insurance markets are immature, focused only on the provision of indemnity insurance, often bundled with life and other insurance products to stay profitable.
- VHI is not the main source of health revenues in any country (including the U.S.), but it can be **complementary** to the government financing program (covers cost-sharing), **supplementary** (covers goods and services not financed through the public system), or **duplicative** (is an alternative for people who opt out of the public system or choose to have dual coverage).
- **Complementary VHI** to cover co-payments led to financial sustainability problems in some countries, because typically higher users of care purchase additional coverage (e.g. Slovenia and Croatia), which is known as **adverse selection**. Adverse selection is a problem when individuals have the choice whether or not to purchase insurance. In this case, healthier individuals often opt out, and the risk pool is left with more

- expensive individuals to cover. There have also been problems of equity with complementary insurance, as higher-income groups are more likely to be insured (e.g. France).
- A sophisticated legal and regulatory framework is necessary to foster a well-functioning market for private VHI to ensure that it does not skim healthier and wealthier individuals from the public system, and that the failures that lead to reduced access for higher need individuals are avoided.

Recommendations:

- **For Kosovo, it is recommended that a payroll tax for the health sector not be introduced at this time, but the organizational and structural changes of a SHI system, including a purchaser-provider split, still be considered.**
 - - Payroll tax-funded SHI is unlikely to result in additional revenues for the health sector in Kosovo, even under the assumption of a 15 percent contribution rate, which would be one of the highest in Europe.
 - The organizational and structural changes of a SHI system mainly financed through revenues from general taxation, however, may allow current resources to be used more efficiently and drive higher quality of health care services. It will also provide a mechanism to integrate and pool additional revenues from multiple sources.
- **It is recommended that Kosovo consider the following options to generate adequate revenue for the health sector:**
 - - **Develop a health financing actuarial model** to project future revenue flows under alternative macroeconomic and demographic scenarios and future demand for and costs of services. The model will make it possible to make policy decisions that align available resources with government commitments for covered services. Using this model, a basic benefit package can be defined that can be funded from government commitments, making explicit what is and is not covered.
 - **Set medium-term expenditure targets to increase general revenues.** Based on the actuarial health financing model, the government may set targets for health sector spending. Some governments adopted MTEFs that include expenditure targets for health, often defined in terms of percentage in GDP or share of government spending. Such targets have been most successful when they are set at realistic levels for the macroeconomic and fiscal context, and when they have been accompanied by changes in service delivery and other measures to improve efficiency in the health sector.
 - **Consider indirect taxes for health.** These may include taxes designed to reduce behavior that increases health care demand and costs, such as taxes on cigarettes and alcohol. Such taxes could improve health status and raise revenues while reducing

demand for health services, since smoking and alcohol consumption would be reduced.

- **Analyze the future potential for private VHI.** Explore the potential future viability of supplementary VHI by completing an analysis of out-of-pocket expenditures, including informal payments; a marketing review of consumer demands and current level of trust in the insurance market; a review of incentives and disincentives for consumers and employers to purchase insurance; a review of legislation and regulation regarding the ability of Kosovo firms and EU-market firms to sell health insurance in Kosovo; and a review of the current regulatory structure and options for strengthening capacity.

2. Risk pooling

Pooling of funds in the health sector (consolidating revenues from different sources) allows funds to be allocated and managed most efficiently, and spreads the risk of health care costs across individuals and across time. Risk pooling is based on pre-payment into the pool, and therefore lowers the out-of-pocket price for medical care at the time of utilization and reduces the risk of catastrophic expenditures. If Kosovo establishes a HIF to pool health care funds, policy decisions about the institutional structure of the risk pools will have to be made.

Policy decision: Choose the institutional structure for risk pooling: single or multiple risk pools

Objective: Reduce fragmentation in health care risk pooling to improve efficiency (through better managed funds and consolidated purchasing), and equity (by spreading risk across more individuals and maintaining fair contribution rates).

Options:

- **Single risk pool.** Some countries have single risk pools that can be financed out of general government revenues, payroll taxes, or other sources. In a single risk pool, revenue (regardless of the source) is placed in a single central pool from which a defined package of health care services is purchased.
 - A single risk pool may be more efficient for countries with smaller populations, because smaller, more fragmented risk pools can be financially unstable, as they tend to have more variation between actual and predicted expenditures.
 - The Kyrgyz Republic and Estonia are examples of transition countries that have abandoned fragmented risk pooling and moved to a single pool/purchasing system, which substantially improved access to care.
- **Multiple risk pools with or without competition.**
 - Some countries have multiple risk pools that do not compete. Multiple risk pools can be created by decentralization, making individual regions separate risk pools, or when

members are assigned to risk pools based on their professional affiliation. Mexico, for example, has a risk pool in the social security system for formally employed beneficiaries, and a separate pool for poor uninsured individuals. Such parallel pools often lead to two-tiered health systems with inequitable funding levels and quality of services. Regional risk pools are also often inequitable, because without redistribution (as is currently the case in Kosovo and in Bosnia), the level of funding in each pool is limited by the ability of the region to raise funds.

- Competition between multiple insurance funds (public and/or private) has been introduced in some countries to capture the benefits of competition for members based on cost and quality of service. Experience shows, however, that multiple insurers mainly compete for lower-risk members in their risk pools. Competition has not reduced health expenditures or brought about improved access to coverage and quality of services.
- **Multiple risk pools with competition and risk equalization transfers.** Some countries with multiple competing risk pools attempt to mimic single risk pools by redistributing a portion of revenues from low-risk pools to higher risk pools to discourage insurers from selecting low-risk members.
 - Risk-equalization schemes (as in the Netherlands and Switzerland) attempt to predict the total health care expenditure of individuals enrolled in an insurance pool and use adjustment coefficients to scale up or scale down the amount of funds in a pool by redistributing based on the aggregate risk. Risk-equalization depends on sophisticated data collection and analysis, and sophisticated governance structures.
 - Risk-equalization mechanisms across insurers have been criticized because it is difficult to accurately predict risk, particularly in small pools, so the adjustment is incomplete.

Recommendations:

- **A single risk pool under the HIF is recommended for Kosovo, because of Kosovo's relatively small population and insufficient institutional capacity to manage multiple risk pools.** The single pool should consolidate funds from central and local sources, across all geographic areas, and across all levels of care (primary, secondary and tertiary). The funds can be distributed to providers through new provider payment systems that allocate funds according to the quantity and quality of services provided, and an equitable resource allocation formula.
- To ensure solidarity among the healthy and the sick and limit adverse selection, insurance enrollment and eligibility for service use should be mandatory for all people living in Kosovo.

3. Benefits, eligibility and entitlement

Policy decision: Define the benefit package; who will be eligible to receive publicly financed services, which services will be financed, and the level of cost-sharing.

Objective: Develop a benefit package that covers priority services and ensures equity in utilization of health care, while balancing commitments with available resources.

Options:

- Some countries have chosen to realign commitments in the benefit package with available resources by introducing a negative list of services, which are explicitly excluded from coverage.
- Other countries have created a positive list of covered services using a cost-effectiveness criterion, or covering those services that are expected to bring the highest health gain for the lowest cost, particularly for the poor and vulnerable groups. In Kyrgyzstan, for example, everyone is entitled to receive free basic primary health care, while other services, such as hospital care and essential drugs, are covered but with co-payments, with some population groups partially or fully exempt.
- The definition of the benefit package has proven to be a politically difficult process in most transition economies. Countries that have not addressed the mismatch between resources available and commitments for free care, however, find that rationing decisions are made informally through, for example, rising informal payments or reduced quality of care.

Recommendations:

- **A limited basic benefit package could be made available to all and fully financed by current general tax revenues.** The draft health insurance law in Art 13ff defines a comprehensive benefit package under insurance that covers primary, secondary, tertiary care, and treatment abroad. This article should be revised to define a more limited benefit package that is more realistic given current resource constraints.
- **Priority should be given to financing preventive care and other cost-effective services, and providing protection to the poor from catastrophic health expenditures.**
- **The cost of the benefit package could be offset by co-payments from patients.** Priority services could be provided free of charge or at low co-payment rates, while other services may be covered at higher co-payment rates. To ensure equity in access to care, some low-income groups should be exempt or be required to pay lower co-payments. The level of co-payments is a policy variable that can be adjusted over time, depending on the level of resources available.
- **The benefit package can offer some coverage for essential drugs for the entire population.** Since drugs make up a large share of out-of-pocket health spending, at least limited coverage may increase access to needed medicines and provide some financial risk protection for households. In addition, essential medicines are necessary to avoid the

need for more costly services, so drug coverage can also improve efficiency. Including pharmaceuticals in the benefit package would require contracts between the HIF and pharmacies in the public and private sector. Beneficiaries could then obtain their prescribed medicines from all outlets that have contracts with the insurance fund, either for free or with a co-payment.

- **Actuarial costing of the benefit package is essential to ensure a financially sustainable risk pool.** Estimates of the utilization and costs of services in the benefit package is necessary to ensure that commitments are aligned with available resources, and that the risk pools are financially sustainable.

4. Purchasing of services

Health purchasing is the transfer of pooled funds from the purchaser to health care facilities to buy a package of services for the covered population, as defined in a contract. Under strategic forms of purchasing, purchasers take proactive decisions about which health care services should be purchased from which providers, at what quantity and price, and with what expectations for quality and outcomes. Purchasers use different ways to pay providers for care (provider payment methods), which can be used to create incentives for efficiency and quality. Active purchasing strategies can improve equity by compensating providers adequately for treating higher cost patients, drive better quality of care by financially rewarding best practices and improved outcomes, and create incentives for providers to be more efficient and more responsive to consumers

Policy decision: Establish a health purchaser and determine its ownership and legal status

Objective: Establish a health purchaser that will strategically contract with providers and create financial incentives to ensure high-quality services for insured individuals and efficient use of resources.

Options:

- The introduction of SHI in transition economies has been associated with organizational changes (particularly establishing a new purchaser and creating a purchaser/provider split) that have been seen as important for facilitating or even driving health financing reforms.
- Ownership of the purchaser (HIF) can either be **public** (owned by the government), **quasi-public** (autonomous public institution), **private** (owned by shareholders, typically non-profit organizations), or **a combination**. In Eastern Europe, the legal status of health insurance funds is typically autonomous public organizations.
- Some countries establish the **health purchaser as a government agency** (such as a SHI fund) that contracts public and/or private health care providers who are financially autonomous.

- In some countries, the **government delegates the purchasing function to private intermediaries** (such as GP fund-holders in the U.K., private insurance companies in Switzerland, or community health boards in Tanzania).

Recommendations:

- **Kosovo should follow international experience and introduce a purchaser–provider split.** The split between purchaser and providers reduces administrative rigidities generated by hierarchically structured command-and-control models.
- **For Kosovo, an independent HIF with the legal status of an autonomous quasi-public financial institution may be most appropriate.** Very positive experience with the organizational and management form of the Kosovo Pension Savings Trust (KPST) suggests that a health insurance pool/purchaser could be organized similarly as an autonomous entity, managed by a professional team and based on international insurance standards.
- **A claims management contract with a private international health insurance company could be considered.** This would allow building local capacity in insurance management and training local staff on the job. This form of private-public collaboration could also reduce upfront costs for the government in insurance management information system investment.

Policy decision: Define the system of contracting between the purchaser and providers of care.

Objective: Establish a system of contracting that gives the purchaser the authority and legal mechanism to enter into an enforceable agreement with providers to purchaser services in the benefit package.

Options:

- Regardless of the structure of the purchaser, **contracts are necessary to serve as the legal base for the relationship between purchasers and providers.** Contracts define the prices a purchaser will pay for specific services purchased from a provider, and under what conditions.
- **Purchasers often have a legislative mandate to contract with both public and private providers.** However, the low payment rates often discourage private providers from seeking contracts, which has prevented competition among providers and thereby possible market mechanisms to increase efficiency are not fully utilized.
- **Purchasers typically contract only with licensed and accredited providers (public or private).** With a licensing system, the government grants permission to an individual practitioner or a health facility to operate. An accreditation system aims at continuous quality improvement. In OECD countries, health insurers generally contract with licensed and accredited providers, to ensure quality care for their members.

Recommendations:

- **It is necessary for the purchaser to have the competence to select qualified and accredited providers (public and private alike), set performance standards, bargain with the providers on payment methods and rates, and monitor their performance.**
- **Investment in information systems and data collection capacity of the purchaser and health facilities is necessary for a purchaser in Kosovo to function strategically.** It will be necessary to collect provider and patient data on the provision of care, demographics and health status, and finances to evaluate provider performance and use results in purchasing decisions to contract selectively with providers.

Policy decision: Establish a provider payment system for outpatient care

Objective: Develop a provider payment system for outpatient services that encourages health promotion and prevention, high quality of services, and efficient use of resources.

Options:

- Primary health care (PHC) in most European countries is increasingly paid by capitation and based on the number of individuals registered with the provider. In a capitation system, the provider is paid, in advance, a pre-determined fixed rate to provide a defined set of services for each individual enrolled with the provider for a fixed period of time. The capitated rate is typically adjusted for the demographic characteristics of the population and geographic differences.
- Capitation can encourage efficient use of resources and an emphasis on prevention, because providers keep any savings they generate by keeping the enrolled population healthy and reducing utilization of expensive services. Capitation may also therefore lead to under-provision of services. To avoid the potential negative outcomes, capitation systems often include monitoring systems or free choice of providers, so “the money follows the patient,” to increase the incentives for high quality care.
- In some countries, PHC providers are paid a mixture of salary and capitation, or a mixture of capitation and fee-for-service (FFS). In a smaller number of countries, PHC providers are still government employees paid a salary.
- Outpatient care, particularly specialist services, is paid in some countries on a fee-for-service basis. In these countries, cost escalation has been a problem.

Recommendations:

- **The current capitation system for PHC providers should be revisited** to be based on (i) the number of individuals registered with the PHC facility; and once data are available on (ii) the age/gender distribution of the registered population.
- **Once information systems and performance measurement have been institutionalized, the MOH should explore the possibility** to identify possible performance indicators and measure the performance of providers. There should be

public reporting of results (for example, preventive care compliance) so that consumers know who the better performing providers are.

Policy decision: Establish a provider payment system for hospital care

Objective: Develop a provider payment system for hospital services that encourages high quality of care and efficient use of resources.

Options:

- To contain growth of hospital expenditures and improve productivity, hospital payment in Western Europe has gradually moved from FFS and per diems to global budgeting and case-based payments, such as DRGs (hospitals receive a fixed amount per treated case, adjusted for the type of case).
- Most of countries of the South Eastern Europe region are moving from input-based budgets for hospitals to some kind of case-based payment.

Recommendations:

- Kosovo will have to invest substantially in its hospital payment system to move from the current line-item budget to cover operating costs towards some case-based payment.
- **If Kosovo plans to implement a case-based hospital payment system, it is recommended that steps be taken first to ensure strong contracting procedures are in place, a well defined basic benefit package, as well as functioning information systems and the capacity in hospitals to manage their internal resources, including accounting and billing systems.**

Policy decision: Define the level of health facility management autonomy and how it will be achieved.

Objective: Create the flexibility for health facility managers to respond to new incentives created by the health purchaser.

Options:

- A purchaser-provider split and new provider payment systems require that health care managers have the authority to make internal decisions and respond to the new incentives. Management responsibility should be increased for key areas, including hiring and firing of staff; determining the number of staff and its skill mix; financial management; determining the level and scope of activities; and deciding on capital developments, the number of beds, and technology mix.
- Provider autonomy must be accompanied by increased transparency, reporting, and annual financial and performance audits to prevent management failure.
- Often, the legal status of health care providers must be changed before managerial authority can be delegated. In European countries, for example, health care providers

gained managerial autonomy when they became privatized. In Bulgaria, PHC physicians have the legal status of independent contractors rather than civil servants.

- Options for the legal status of health care providers found in transition countries to increase management autonomy include: budget unit subject to public finance law (least autonomy); separate legal public sector entity, such as extra-budgetary unit, trust, or joint stock company (can enter into contracts and generate non-budget sources of funding); private not-for-profit institutions (most autonomy).

Recommendations:

- **Management decisions should be delegated the facility director level.** Following the subsidiarity principle and the Kosovo Health Law, the responsibility and accountability for management and financial decisions rests with the hospital and PHC directors.
- **This autonomy needs to be accompanied by professional financial management in health facilities with transparency, reporting, and annual financial and performance audits.** Managers must be equipped with the necessary resources and tools to make decisions, and kept accountable for performance results.
- **To increase the power of management responsibility and autonomy, hospital and PHC facilities could be corporatized as nonprofit autonomous organizations, competing for patients with private providers.** On the municipality level, a community oversight body should be formed to supervise the functioning and performance of the PHC center or hospital and ensure transparency in major financial and operational decisions.

5. Governance

Governance in the health system refers to the institutional structure and capacity, roles and relationships between different actors, and accountability mechanisms that ensure there is a strategic vision for the health sector, which is implemented transparently with appropriate checks and balances. The health sector can be particularly vulnerable to corruption, and experience has shown that the introduction of a health insurance fund in many countries has suffered from inadequate governance structures, poor financial management, lack of guidelines for the investment of insurance funds, weak banking systems, and incidents of fraud and the misappropriation of funds. **Establishing a clear governance structure with a supportive legislative and regulatory base is an essential pre-condition for the implementation of a social health insurance system in Kosovo.**

Policy decision: Mechanism of representation and form and scope of governmental supervision

Objective: Ensure an adequate capital base, sufficient reserves, investment in appropriate financial instruments, manage political risk, and at the same time ensure that the system provides high quality health care.

Options:

- It is common for SHI system to be governed by a board of directors or governors, whose members are elected or appointed by shareholders, employers, or beneficiaries.
- The degree of government supervision is likely to be higher in a system that is monopolized and highly subsidized by public resources.

Recommendations:

- **Kosovo could consider a governing board whose membership combines professional staff and independent government representatives.** The appointment process and the terms of operation of the board and each member would need to be clearly specified in the law.
- **The Ministry of Justice or Finance might head the HIF supervisory board to ensure independence.** Board membership might include representatives of government, Parliament, insured persons, and employer organizations. The experience of the Kosovo Pension Pillar II Fund suggests that the inclusion of international experts on the board should be considered as a means of sharing experience. Alternatively, the representative of the International Civilian Operation could be a member during the transition period.
- Following the successful experience of the Kosovo Pension Savings Trust (KPST), **the regulatory and oversight body of the health insurer could be the Banking and Payments Authority of Kosovo.**

Policy decision: Financial management processes of the HIF

Objective: A HIF is fundamentally a financial institution, so ensuring sound financial management is essential for avoiding insolvency.

Options:

- A SHI system usually applies accrual-based accounting to ensure that changes in the economic environment are accounted for as they occur, rather than when a cash transaction is made.
- Effective internal and external audit systems are necessary. HIFs often contract private auditing firms to conduct external audits, because health insurance accounting is different from typical public sector accounting, and public sector auditors are not familiar with private sector accounting standards.
- Even when the HIF is a publicly owned institution, countries often allow staff of the HIF to receive salaries close to those in the private financial sector in order to attract and retain high caliber professionals, but without the civil service employment guarantees.

Recommendation:

- **It is important that Kosovo promptly establish an efficient and accountable financial management process for the HIF, including accounting, reporting, and auditing.** An international accounting standard – modified as necessary – should be

applied. The Office of the Auditor General needs to develop an effective strategic plan and the capacity to provide a reliable auditing system for the HIF. This requires immediate capacity building in financial management in order for the system to be in place from the beginning of the implementation phase.

Policy decision: Information systems

Objective: Make the insurance system accountable by providing comprehensive and timely information to the public and to regulators.

Options:

- Experience shows that greater disclosure of standardized information significantly enhances institutional accountability.
- A health management information system (HMIS) typically has the following components: (i) membership database; (ii) provider contracting and management systems; (iii) financial management systems; (iv) claims database; and (v) utilization and quality management data.
- A SHI system should rely on existing information systems and build an information technology (IT) system that will handle only additional information required specifically for insurance management.

Recommendation:

- **It is critical that Kosovo invest in the implementation of a carefully sequenced and phased HMIS.** HMIS implementation should start with developing a comprehensive strategy with wider consultation of stakeholders, and based on the strategy, prepare the required legislation, and phase in capacity-building and implementation. The HMIS should produce financial statements and audit reports, basic performance information on contracts with providers, and annual reports on the overall performance of the system.

SUMMARY AND RECOMMENDATIONS FOR IMPLEMENTATION

- The most feasible health insurance option in Kosovo is to **establish a HIF that serves as a single risk pool and purchaser, funded by general tax revenues and indirect taxes.** Kosovo's labor market is too small and fragile to absorb a payroll tax increase. So, insurance revenues should come mainly from the government budget. Kosovo could explore increasing indirect taxes on tobacco and alcohol, as well as on luxury goods, to raise additional government revenues.
- **A single insurance system with mandatory enrollment for all residents is the preferred pooling solution.** Kosovo's population is too small for multiple risk pools, and Kosovo does not have the institutional structure for risk-equalization transfers or risk-based premium definition that would be needed in a multiple insurance system. At the beginning, Kosovo may want to consider contracting out insurance management to an experienced international health insurance company that could also help build human capacity and information technology (IT) in Kosovo.

- **A benefit package should be defined that covers priority services and ensures equity in utilization of health care, while balancing commitments with available resources.** Priority should be given to financing preventive care and other cost-effective services, and providing protection to the poor from catastrophic health expenditures. The benefit package could offer some coverage for essential drugs. Priority services could be provided free of charge or at low co-payment rates, while other services may be covered at higher co-payment rates. To ensure equity in access to care, some low-income groups should be partially or fully exempt from co-payments. Actuarial costing of the benefit package is essential to ensure that commitments are aligned with available resources and that the insurance system is financially sustainable.
- **When establishing a HIF, Kosovo may wish to follow the successful performance of the Kosovo Pension Pillar II Trust Fund.** The Pillar II Fund is a public autonomous organization managed by an independent professional team. The HIF could be established as an independent autonomous organization staffed by Kosovar professionals recruited locally and from the international diaspora working in health insurance companies. The governing board could have a combination of local and foreign membership. The regulatory and oversight body of the HIF could be the Banking and Payments Authority of Kosovo.
- **Substantial organizational and institutional reform is needed to allow providers to respond to the new financial incentives.** To implement an HIF, the organization and management of health facilities would have to be modernized to reflect a European standard. Reforms include separating purchaser and provider, increasing management autonomy for health facility directors, and passing laws to give health facility directors managerial authority. The government will have to play a strong stewardship function through accreditation and quality control of all facilities.
- **Contracts between the HIF and providers should reward better quality and efficiency in the provision of care.** The HIF should purchase care selectively, monitor and evaluate the performance of contracted providers, and exclude non-accredited providers from contracting. Provider payment reforms will take time and—as in neighboring countries—could develop from the current line-item budgeting toward case-based payment for hospitals and a capitation for outpatient services. These reforms would require substantial investment in information systems, as well as training of both HIF and health facility staff in data collection and analysis, and the use of analysis to monitor contracts and adjust the care process in health facilities.
- **To implement health financing reforms, the roles and responsibilities of the health sector actors will change, requiring a strong accountability framework.** The Ministry of Health would assume a policymaking and stewardship role. The Ministry of Economics and Finance would have to redirect the flow of health funds to the HIF, which will assume full responsibility for risk pooling and purchasing of primary, secondary and tertiary health care. The HIF will contract with accredited providers who offer a benefit package to the population at prices set in the contract with the HIF. Providers will be given increased autonomy to produce these services most effectively, and their performance will be evaluated against a set of performance standards.

- **Timing and sequencing is critical to allow the health system to prepare for and absorb the necessary changes and not overwhelm the capacity of the system.** A three-phased gradual approach is recommended to develop and implement these reforms, with Phase 1 focusing on preparation, and Phase 2 and 3 each extending over four to five years to implement, adjust, and complete reforms. Phase 1 may take one to two years, serving mainly to set up the legislative, regulatory, governance, and strategic direction. Phase 2 focuses on implementing and adjusting reforms. Phase 3 is the institutionalization phase where the new financing and delivery system should become routine and prove sustainability.
- **The impact of major health financing reforms should be monitored and evaluated to identify and correct for adverse effects at an early stage.** It will take several years to develop and implement major health financing reforms, and they will affect various stakeholders, whose support for the reforms must be gained. Some of the changes may lead to unexpected adverse effects that would need to be corrected. A monitoring and evaluation framework is needed to track progress and detect problems. A baseline analysis should measure the current situation. Findings from the baseline could help define the benefit package, levels of cost-sharing, and provider payment reforms, and be used for comparison over time to identify progress and reform areas that need strengthening.