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# Chapter 7: Between Modern Design and Old Political Habits: The Kosovar Pension System under Threat

Igor Guardiancich

## Introduction

Kosovo falls within the broader family of Mediterranean welfare states that are characterized by GDP per capita levels lower than in most advanced political economies, relatively underdeveloped social protection, a higher proportion of the population at risk of poverty, and higher levels of economic inequality.

These states share common socio-economic and historical idiosyncrasies:

> Late industrialization, labour market segmentation and a large shadow economy, a recent memory of colonial rule or non-democratic regimes and weak central states with ineffective public bureaucracies have implications for the funding, structuring and functioning of welfare states (Gal, 2010: 283).

They are, moreover, characterized by three dominant cultural traits: a prominent role of religion, the traditional family and patron-client relations.

All of these are present in Kosovo. However, due to the presence of the international community following the conflict with Serbia in 1998-99, under the aegis of the United Nations Interim Administration Mission in Kosovo (UNMIK) acting as an international civilian administration, several social security institutions have been externally imposed.

One of them is the multi-pillar pension system, designed by consultants funded by United States Agency for International Development (USAID), with the involvement from representatives of UNMIK, the European Union (EU), the International Monetary Fund (IMF), the World Bank, the UK's DFID (Department for International Development) and the International Labour Organization (ILO).

Its zero pillar – a universal non-means-tested basic pension for the whole resident population aged 65 and above – is an administratively very simple system, created to supplant the country's adverse labour market conditions. Its universal character is unique within the Mediterranean cluster. Here, pension schemes usually display extreme fragmentation (for example, in Italy there were dozens of micro-schemes), itself the result of clientelistic party competition, which thrives on the targeting of specific groups in exchange for political gain (Ferrera, 1996).

As the international community gradually withdrew after Kosovo declared independence in 2008, so-called benefits clientelism, i.e. the exchange of monetary rewards for political support (Taborda, 2017), started affecting all publicly financed sectors. A number of special pension schemes have proliferated, and benefits to narrow constituencies, *in primis* the independence war veterans, have ballooned. These represent one of the most burdensome legacies of the Yugoslav wars that several of the countries involved in the conflicts still have to bear (Bartlett, 2013; Guardiancich, 2013).

Consequently, the new schemes and soaring benefits attracted harsh criticism of the IMF (2015; 2016), which demanded cutbacks to comply with the Stand-By Arrangement (SBA) agreed in 2015. Despite the early admonishments, the Ministry for Labour and Social Welfare proposed to partly dismantle the universal basic pension in order to free up resources to finance these additional schemes. The draft legislation included the introduction of means testing (and, possibly, a separate administrative unit), which would weaken the pension system's Beveridgean objectives.

As retrenchment of welfare schemes is often a politically risky affair (Weaver, 1986; Pierson, 1994), this contribution explains why such a universal and efficient scheme has been targeted to free up resources. Drawing on up-to-date literature on blame avoidance and employing official documents as well as interviews with practitioners, the study shows that the low political salience of Kosovar basic pensions makes them vulnerable to potential cuts. By definition, the universal scheme can be used for benefits clientelism only at a high cost (by disbursing rewards to everyone) and with uncertain results (as there is no or excessively widespread targeting). Consequently, they represent a 'path of least resistance' to free up readily available resources (Bonoli, 2012).

This chapter argues that the Labour Ministry's planned intervention is unnecessary, potentially harmful to the poorest strata of the elderly population and out of touch with Kosovo's socioeconomic reality. In response, the author recommends a radical change in reform strategy.

**The Kosovar pension system: genesis, design and evolution**

There are several reasons why Kosovo underpinned its multi-pillar pension reform with a universal non-means-tested pension. Specific problems relative to the Yugoslav pension system and the conflict rendered the existing institutions unusable (Gubbels et al., 2007). More important, the unfavourable labour market conditions hardly allowed for the *ab ovo* introduction of contributory pensions. Finally, a lack of trust in Kosovo's newly established political institutions prompted the international community to lock in the reforms as fast as possible.

Starting with the historical legacies, Kosovo inherited unviable retirement institutions. The Serbian 1990 Labour act for extraordinary circumstances dismissed 145,000 Kosovar Albanians from civil administration posts, public services, and economic enterprises. The Yugoslav pay-as-you-go (PAYG) system covered fewer than half of the circa 110,000 persons over the age of 65. Moreover, during the conflict, not only almost half of the population was displaced, but also the Serbian authorities stopped paying benefits to ethnic Albanians.

Finally, during the NATO intervention, a cruise missile and the ensuing fire partly destroyed the contributory records of working age Kosovars.

The extremely precarious situation of the labour market affected the pension system's design (see Table 1). Given the low employment and high unemployment rates, few regularly contribute to the social security system and many suffer from contributory gaps.

**Table 1 Labour market indicators for Kosovo (2012-14)**

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| **Employment rate total (20-64)** | 29.7 | 33.0 | 31.3 |
| **Employment rate men (20-64)** | 46.6 | 51.5 | 48.4 |
| **Employment rate women (20-64)** | 12.4 | 14.9 | 14.5 |
| **Unemployment rate total** | 30.9 | 30.0 | 35.3 |
| **Unemployment rate men** | 28.1 | 26.9 | 41.6 |
| **Unemployment rate women** | 40.0 | 38.8 | 33.1 |

*Source:* Eurostat.

The magnitude of the phenomenon increases when own-account and family workers are included in the picture (some 31.8 percent of all employed persons in Kosovo in 2014, according to Eurostat). These groups often lack social security coverage and proper labour and fiscal records.

In sum, Kosovo has a large informal economy, which provides the means for self-subsistence to the population but limits the access to formal types of social insurance and reduces government revenues. Several reasons account for the large levels of informality (Krasniqi and Topxhiu, 2012).

First, the demographic composition of the population is anomalous in the European context. According to the 2011 census (KAS, 2013), over 47 percent of the population was younger than 25, leading to an estimated 35,000 new job seekers each year, which the labour market cannot absorb (Bertelsmann Stiftung, 2016). Hence, in the late 2000s, social security did not cover up to two-thirds of workers.

Second, the characteristics of post-socialist transition economies (the rapid distancing from self-management and low salaries in the formal economy) generate informality. The Kosovar informal sector's size was estimated at 27-35 percent of GDP in 2004-2006 (Schneider, Buehn and Montenegro, 2010).

Finally, Kosovo witnessed large-scale outflows of working-age people due to the conflict and economic difficulties. So, remittances and visits by members of the diaspora support families, seasonally boost consumption, but at the same time make it difficult to identify households in need and distort the structure of fiscal revenues (Feher et al., 2016).

In sum, the autonomous province had too fragile welfare institutions to build upon and a dysfunctional labour market. Additionally, Kosovar leaders were not eager to re-implement the Yugoslav pension system, as it was associated with the repression of the Milošević period.

Under such conditions, the international community designed a set of original social policies: the basic pension was the first law passed by the Provisional Institutions of Self-Government (PISG) in the newly created Kosovo Assembly.

The UN administration had very little trust in the newly established Kosovar institutions, including the PISG (Héthy, 2005). The IMF feared that the reforms would have been probably debated, delayed and altered had Kosovo not been under international governance (Gubbels et al., 2007). Hence, legislation was passed before a Kosovar government was in place, thereby ensuring independence from local political involvement (Cocozzelli, 2009).

On the one hand, the international community's concerns were not unfounded: despite the efforts to develop a responsible and accountable administration, only those parts insulated from political influence did not suffer from low competence or develop extensive patronage networks (Skendaj, 2014). Similarly, it was expected that pensions, once the authority was definitively transferred to the PISG, would have become vehicles for benefits clientelism. On the other hand, the hasty adoption generated tensions between social welfare reforms that are still unresolved.

**The current design**

The current pension system is the result of several amendments, the latest one through the 2014 Law no. 04/l-131 on pension schemes financed by the state. Originally, the multi-pillar design was simpler, a textbook version of what was advocated by the World Bank (1994) in the 1990s. It consisted of a first pillar comprising a universal basic old-age pension and a disability pension narrowly focused on total and permanent disability, a second mandatory fully-funded defined-contribution contributory pillar, managed by the Kosovo Pension Savings Trust (KPST) and voluntary private third pillar schemes.

Focussing on state-financed pensions, the 2017 budget covered 12 different schemes, meaning that the system's fragmentation has been rising in recent years. This trend fits perfectly with what the literature on the clientelistic political competition in the Mediterranean welfare cluster predicts (Ferrera, 1996; Gough, 1996). Additionally, two schemes are not yet active (the work disability pension and the family pension) for budgetary reasons. The IMF (2015) has been extremely critical of their ill-conceived design and unsound targeting. Table 2 gives a succinct description.

**Table 2 Selected Kosovar old-age and disability pension schemes**

| Scheme | Target group | Age | Earnings tested | Pension tested | Benefit type and amount |
|---|---|---|---|---|---|
| **Basic age pension** | All | 65+ | No | Yes | Flat (€75/month) |
| **Contributory pension** | Beneficiaries based on law from before 1999 | 65+ | No | Yes | Education-linked (€158-230/month) |
| **Disability pension** | 100% disability | <65 | Yes (categorical) | Yes | Flat (€75/month) |

| | | | | | |
|---|---|---|---|---|---|
| **Work disability pension** | Work accident or professional disease | <65 | Yes (categorical) | Yes | Flat (€75/month) |
| **Family pension** | Beneficiaries based on law from before 1999 or family of work disabled | Spouse <65 | Yes (categorical) | Yes | Flat (€50/month + 20% per eligible child) |

*Source*: Feher et al. (2016, 32).

Two old-age pension schemes constitute, together, the Kosovar zero pillar (using more recent World Bank terminology, see Holzmann and Hinz, 2005). The basic age pension is still a tax-financed universal flat benefit, covering all citizens aged 65 and over, who do not qualify for other budget-financed schemes and who are residents of Kosovo.

Individuals have to report at an office designated by the Ministry at least every six months to qualify for continuous benefit receipt. The Ministry of Labour and Social Welfare administer the plan. Between its inception in 2002 and the end of 2015, the scheme has become more generous (benefits increased from 28 to 75 euros/month) and beneficiaries climbed from 93,000 to 132,000.

Until 2015, the Ministry of Finance annually determined the pension benefit, based on the minimum consumption food basket. Indexation was unsystematic (neither linked to prices, wages or GDP) and conditional on the budget. With the Law no. 04/l-131, the Finance Minister is still in charge and again determines the amount depending on the budget and the inflation rate. The cost of the program in 2015 was a bit less than 2.1 percent of Kosovar GDP, that is, circa 11 percent of total Government's expenditures and circa 40 percent of all expenditures on social contributions and benefits, as shown in Table 3.

**Table 3 Selected national and government accounts**

| | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** |
|---|---|---|---|---|---|---|
| **GDP (million €)** | 4,402.0 | 4,814.5 | 5,058.7 | 5,326.6 | 5,567.5 | 5,771.5 |
| **GDP per capita (€)** | 2,480 | 2,672 | 2,799 | 2,935 | 3,084 | 3,258 |
| **Govt revenues (% of GDP)** | 25.9 | 27.2 | 27.3 | 25.5 | 24.2 | 29.6 |
| **Govt expenditure (% of GDP)** | 27.7 | 28.3 | 28.6 | 28.0 | 27.2 | 27.9 |
| **Social protection spending** | | | | | | |
| **- as % of GDP** | 3.9 | 3.7 | 3.9 | 4.3 | 5.1 | 5.3 |
| **- as % of govt exp.** | 14.1 | 12.9 | 13.7 | 15.3 | 18.7 | 19.0 |

*Source:* KAS (2016).

The contributory pension was introduced in 2007 (Decision of the Government no. 13/277), in part due to the pensioners' dissatisfaction with a basic pension that does not take into account previous contributions (arguably some of the old records are intact) (Loxha, 2012). It is budget-financed and targeted to citizens aged 65 and over with at least 15 years of contributions prior to 1999 into the social security scheme of Yugoslavia (Table 4).

Here as well, benefits and beneficiaries increased over time. In 2008, it amounted to a top-up of 35 euros/month over the basic pension disbursed to circa 28,000 pensioners. In 2015, the over 40,000 eligible individuals were entitled to a flat benefit of 140 euros, with the same residence and administrative procedures in place as for the basic pension. The total budgetary cost amounted to almost 1.2 percent of GDP.

**Table 4 Basic and contributory pension indicators**

| | **Basic age pensions** | | | | **Contributory pensions** | | | |
|---|---|---|---|---|---|---|---|---|
| **Year** | No. retirees | Monthly rate | % of per capita GDP | Annual budget (mio €) | No. retirees | Monthly rate | % of per capita GDP | Annual budget (mio €) |
| **2010** | 109,585 | €45 | 21.8% | 63.641 | 30,641 | €80 | 38.7% | 30.900 |
| **2011** | 107,145 | €45 | 20.2% | 61.192 | 32,415 | €80 | 35.9% | 31.670 |
| **2012** | 113,043 | €50 | 21.4% | 69.204 | 34,722 | €101 | 43.3% | 42.038 |
| **2013** | 117,042 | €60 | 24.5% | 87.340 | 36,015 | €112 | 45.8% | 49.413 |
| **2014** | 125,883 | €75 | 29.2% | - | 38,651 | €140 | 54.5% | - |
| **2015** | 132,000 | €75 | 27.6% | - | 40,365 | €140 | 51.6% | - |

*Source:* KAS (2016).

In 2014, there have been several changes to the contributory pension. First, various non-contributory periods count towards eligibility, such as years of work in the parallel health, education and other sectors in Kosovo between 1989 and 1999. Second, all eligible beneficiaries are granted an extra 25 years of notional earnings history, rewarded with a 0.5 percent increase per service year. So, the benefit increased to 158 euros/month as of 2016. Third, there will be benefit differentiation according to the individual beneficiary’s education attainment to restore some of the lost earnings-related nature via a proxy.

*International comparison*

Given Kosovo’s status as a lower-middle income country and labour market problems, the situation begged for a different approach to its pension system than in the rest of post-socialist countries. Kosovar reforms are part of a wider trend, where contributory pensions are combined with non-contributory ones (the basic pension), to increase coverage in developing countries with large informal labour markets (ILO, 2017). Universal non-means-tested pensions are perceived to have many advantages over targeted ones. They are ‘probably the best way to provide poverty relief to the elderly. Considering the difficulty of identifying who among the elderly is poor, the principal merit of the program is that its universality avoids the targeting issue’ (Holzmann and Hinz, 2005: 95).

Such unconditional schemes are, however, rare (see Willmore, 2007). Kosovo is the only transition post-socialist country that adopted one. Additionally, the basic pension stands out in international comparison due to a number of features. If the qualifying age is average (it ranges from a low of 60, e.g. in Mauritius, to 75 in Nepal), Kosovo is the only country where current residency is the only additional requirement. Elsewhere, the prospective beneficiary has to demonstrate to either have resided there for a number of years, to be a citizen or both.

Regarding the coverage, the Kosovar basic age pension has slightly expanded in the past few years, thereby paying benefits to circa 7.4 percent of the population in 2015. This is relatively high in international comparison: in the mid-2000s, only New Zealand and Mauritius registered more beneficiaries.

In terms of costs, the Kosovar basic age pension has been often depicted as excessively generous. Initially, benefits totalled 45 percent of per capita GDP, higher than the recommended and non-distortionary 15-20 percent (Palacios and Sluchynsky, 2006). However, the benefit being adjusted ad hoc, its value has fluctuated substantially; at times it has not distanced itself excessively from the recommended values (see Table 4).

With regards to administrative costs, Kosovo’s plan, despite being the least expensive per member in absolute terms, is relatively inefficient when costs are adjusted for income (Sluchynsky, 2009). That is surprising, given that operationally it is the simplest program: a) it pays a flat benefit to an easily discernible group; b) the civil register identification is the sole and sufficient proof of identity, age and residence; c) disbursement of all payments happens through an automated centralized process with a combination of easy-to-read bank coverage maps, joint account options and complementary mobile bank services.

**Clientelism and fragmentation**

The brief Kosovar political experience is replete with instances of clientelistic party competition, which manifests in all its forms such as benefits, patronage, and corruption. With regards to benefits clientelism, the government of PM Hashim Thaçi (2008-14) of the Democratic Party of Kosovo (PDK) increased public sector wages and all non-contributory pensions by some 25 percent prior to the 2014 elections, at the expense of public investment projects. The hike in old-age retirement benefits alone cost the budget more than 40 million euros in 2015, and the annual bill is bound to increase to 66 million by 2017. The move has to be seen as a one-off event, as its cost was excessive and the targeted population too heterogeneous.

Thaçi, now Kosovo’s President, and a (former) member of the inner circle of the Kosovo Liberation Army (KLA) and the PDK constituted from its political wing, made sure the subsidization of veterans was high on the agenda. In particular, the Kosovar Assembly passed Law no. 03/L-100 on the pensions for Kosovo Protection Corps members in 2008, Law no. 04-L-84 on pensions for members of the Kosovo Security Force in 2012 (the KPC, later KSF, were the civilian successors to the KLA) and Law no. 04-L-261 on Kosovo Liberation Army veterans in 2014.

In each case, the IMF has been extremely critical. The KPC and KSF are non-contributory, earnings-related final salary schemes, whose eligibility is relaxed and benefits generous (members can retire as early as 45/50 in KPC/KSF, and benefits are not lower than 50/60 percent of the final salary). Worse even, the war veterans’ pension (plus additional benefits paid to KLA war invalids, martyrs’ families and the families of civilian victims of the war) was set to become the most expensive special benefit program in Kosovo, due to its generosity, ease of access and extension, thereby exacerbating the safety net’s inequities (Feher et al., 2014: 18-23).

Although the government led by PM Isa Mustafa of the Democratic League of Kosovo (LDK), in coalition with PDK, vowed to cap veteran benefits at 50 million euros in the 2017 budget, these have soared to almost double that. The main reason, again in line with theoretical expectations, is that over 46,000 people are eligible, which more than doubles IMF's initial estimate of 18,000. The number swelled partly because the paramilitary organization Armed Forces of the Republic of Kosovo (FARK) was LDK's military wing, which also requires its share of the welfare pie, in fierce (and bloody) competition with the KLA. Such cronyism spurred the protests of senior members of the War Veterans' Association, which complained that the list includes people who never saw the front lines, thereby enabling associates of both ruling and opposition parties to claim welfare (Quirezi, 2016).

**Dismantling the basic pension**

The costly fragmentation of the Kosovar pension system obviously requires additional resources, which could be carved out from schemes that are ill-suited to be further exploited as a source of benefits clientelism, such as basic pensions. As cutting welfare is politically costly, a rich literature sprung up in the mid-1990s, explaining that reforms nonetheless succeed when politicians successfully deploy blame-avoidance strategies. These include obfuscation (through the low visibility of cutbacks), division (creating a wedge between otherwise homogeneous groups), compensation (ranging from direct financial pay-outs to exclusion from reforms) and justification tactics (convincing the public of the reforms' necessity) (Weaver, 1986; Pierson, 1994; Green-Pedersen, 2003).

Plenty of governments, e.g. Berlusconi in Italy or Juppé in France in the mid-1990s, have been wrecked by public opposition to welfare cuts. When losers to a proposed change are veto players, a government may search for viable options instead of using blame avoidance. By choosing the safer path of least resistance, the costs are concentrated on marginal groups, such as widows, younger pensioners, temporary workers etc. These groups are less likely to mobilize effectively, especially when complementary reforms are pursued through long phasing-in periods and liberalization at the margin.

Given the basic age pension's cost, universalistic objectives and particular demographic characteristics, the scheme offered a path of least resistance to retrenchment. Indeed, during the spring of 2016, the Kosovar Ministry of Labour and Social Welfare started a process that would have turned the universal scheme into an income-targeted scheme.

This chapter contends that this was an ill-conceived reform, and that the policymaking process was deeply flawed. The few gains achieved would likely be offset by the appearance of horizontal leakages and increased administrative costs. Consultation with civil society and the social partners almost did not take place. The scope of changes presumably exceeded those allowed by the chosen procedure. In addition, the content did not take into consideration any priorities other than redirecting the liberated funds towards politically more profitable schemes (KSI, 2016).

**The Proposed Changes**

A 2016 Concept Paper of the Labour Ministry envisaged three scenarios regarding the future of tax-financed pensions in Kosovo (Government RK, 2016). The no-reform scenario was deemed to be unfair. First, the basic age pension continues to be paid out to Kosovar citizens permanently living abroad (10-15,000 people) due to excessively lax residence requirements and to pensioners having additional sources of income, as there is no means test. Second, Kosovar citizenship as eligibility criterion may be in breach of the European coordination regime (e.g. Regulation 883/2004) of social security schemes; hence, a better solution than bilateral agreements should be legislated.

An alternative scenario was to draft a new law regulating all pension and disability schemes financed by the state with a single bill. This would: a) introduce nuanced disability scales on which to calculate invalidity benefits; b) create a separate administration for all non-contributory Kosovar schemes (including the special ones for veterans, for the blind etc.). The new administration would have a one-stop-shop in each Kosovar municipality. Although a new law was the preferred solution, the shortages in trained staff, time constraints, a dire labour market situation and the many uncovered citizens with disabilities (only 20 out of 200 receive a benefit) would make the solution exceed budgetary capabilities.

Hence, the favoured option became amending the Law no. 04/l-131. The basic age pension would be replaced by a social age pension, with substantially different characteristics. It is means-tested and implicitly taxed at a rate of 100 percent (so if one's income is less than the social pension, one receives just the top-up). Second, both Kosovar and foreign citizens can draw benefits, provided that they have resided in Kosovo for the past 10 years (and the last five as permanent residents). The benefit becomes non-exportable abroad in the absence of a bilateral agreement. The law would also regulate the main procedures, documents and requirements for the Labour Ministry to monitor the residence and income requirements. Additionally, the criteria for the application to a disability pension would be clarified.

**Substance flaws**

Two of the proposed reform's objectives are particularly problematic. First, the creation of an independent administrative body vis-à-vis keeping the Department for Pension Administration (DAP) within the Labour Ministry clearly duplicates capacity. It is advisable to 'piggyback' on existing administrative structures, as several countries tend to centralize and automatize social security procedures and communication. For example, in Latin America, only Paraguay is reported to have an independent directory in charge of non-contributory pensions. The others either manage them through the institutions responsible for the contributory pension system or for social assistance (Rofman, Apella and Vezza, 2015). Given the lack of trained staff and the unenviable record of patronage, the new administration would be used to appoint cronies and it is likely that there would be few administrative improvements (Skendaj, 2014).

Second, the introduction of an eligibility test takes away the core function of universal poverty alleviation. Introducing a generic means test is, in the Labour Ministry's conception, akin to linking the basic pension to the generic social assistance scheme, which have the same purpose but apply different eligibility criteria (according to the Ministry, the pension ones are soft and prone to abuse, whereas those related to social assistance are hard and solid) (Government RK, 2016).

A targeted system may reduce fiscal costs, it is horizontally more equitable (people who do not need a service/benefit do not get it) and the political support can be higher than for universalism (Grosh and Leite, 2009; Korpi and Palme, 1998). At the same time, however, it requires a complex and expensive targeting system, which, depending on the type (income, pension, proxy etc.) has its own administrative, efficiency and equity problems.

Although there have been advances in targeting in the past decades, this article advises against an ex-ante income test beyond testing against other pension benefits.
First, the experience with social assistance in Kosovo[1] is deemed to be relatively positive in terms of efficiency, but there are coverage gaps, e.g. poor children are excluded (Roelen and Gassmann, 2011). That several categories of the elderly fall off the income-tested scheme might have severe consequences on individual well-being. During the 1996 crisis in Russia, various household lost their entitlement to a public pension. Despite income replacement strategies, the event increased the probability of men dying for all causes within the next two years by five percent (Jensen and Richter, 2004).

Second, strengthening the residence test and the coherence of the pension system is likely to better improve financial sustainability. As means testing in Kosovo is problematic due to economic informality and large inflows of remittances, the required administrative capacity is substantial, and the operating costs are likely to partly offset the prospective savings.

Third, if testing against other pension income is sensible, general income and other means testing creates inactivity and poverty traps. The likely consequences are to severely limit gainful employment or self-employment in retirement and to create tangible disincentives for younger, lower income workers to save or formalize their employment status.

**Lack of consultation, illegitimate procedure, political motivation**

The amendment of Law no. 04/l-131 affects every Kosovar citizen. As such, the revision should include an encompassing consultation process with civil society actors, thereby aiming at reaching consensus. Instead, the procedure has involved mainly the Labour Ministry staff and external (domestic and international) consultants. Public consultations lasted one week only from 22 to 29 January 2016 (Government RK, 2016).

Furthermore, the legal procedure applied by the Labour Ministry's working group was probably unsuitable. The amending and supplementing process allows for a maximum 40 percent change of a law. Exceeding that, a new law should be drafted. Although the number of articles affected falls within the remit, the amendment radically changes the nature of the basic age pension, which makes the procedure *de facto* inadequate (KSI, 2016).

Finally, the stated motives behind the proposed legislation were to harmonize the basic age pension to social assistance and to generate fiscal savings. Such policy objectives neither take into account the *raison d'être* of the Kosovar zero pillar, which is to protect from poverty, nor reveal that the funds would fuel well-targeted benefits clientelism. Rather candidly, the Finance Ministry inserted into the Concept Paper the recommendation to employ the saved

[1] Social assistance benefits are targeted towards poor families on the basis of a hybrid form of targeting, including categorical targeting, a proxy-means (asset) and means (income) test.

funds to finance the family and work disability schemes that were legislated in 2014 but never implemented. (War veterans are the other important group that would benefit, but they are not explicitly mentioned.)

Such retrenchment represents for the government the path of least resistance due to a number of reasons (Bonoli, 2012). First, Kosovo being a very traditional society, the gender imbalance is a fundamental trait of basic age pensions. Women represent almost two-thirds of recipients, due to short or inexistent contributory histories, compared to just 12 percent of those entitled to a contributory one. A reform of the basic pillar would hence overwhelmingly affect women (mainly former family workers). Second, politics and civil society are uninterested in the defence of such constituency. On the one hand, although there are some 6,000 registered Non-Governmental Organizations (NGOs) in Kosovo, there are only a few that are active deal with municipal policy, corruption and environmental issues rather than with social policy (Bertelsmann Stiftung, 2016). As for the social partners, neither the employers nor trade unions are particularly affected. Labour leaders often are themselves pensioners, who hold the belief that people with no contribution record should not be entitled to public pensions. Finally, the recipients of the basic age pension do not represent a major voting platform to be targeted through benefits clientelism, as opposed to the beneficiaries of other special schemes.

**An alternative reform strategy**

The Kosovar pension system shows several inconsistencies with regards to its various components. As the IMF notes, however, most complications are concentrated in special benefit schemes, family and disability pensions. In comparative terms, the zero pillar is less problematic. As advocated by the World Bank, a mixed strategy that tackles the problem on multiple fronts may sensibly improve the basic pension's design efficiency (Robalino and Holzmann, 2009). There are several ways of reducing the costs while preserving universality: taxing pensions as ordinary income; increasing the pensionable age; reducing the benefit ratio; and increasing administrative efficiency (Willmore, 2007).

**Taxation**

As universal basic pensions are financed from general revenue, a way of ensuring both vertical equity and fiscal sustainability is applying a progressive Personal Income Tax (PIT). By doing so, retirees contribute to lowering the costs, with wealthier pensioners paying a proportionally higher share of the burden. This method is successfully implemented, for example, in the Nordic countries, but has not been applied in many lower- and middle-income countries, where administrative capacity is low.

In Kosovo, all social transfers are exempted from PIT. Except for the neediest recipients, beneficiaries should pay income tax and health contributions (Feher et al., 2016). Consequently, all sources of income would be similarly treated, thereby sharing the burden of social security among generations, and improving vertical and horizontal equity. This would, furthermore, create fewer distortionary effects on the labour market, reducing consequently inactivity and poverty traps. Of course, such taxation would hardly apply to recipients of zero-pillar benefits.

People engaged in dependent employment or self-employment who are also benefit recipients should be allowed to continue working. At the same time, they should be subject to a partial claw back of pension benefits as their income rises.

**Eligibility**

An effective way to contain costs and simultaneously increase the adequacy of benefits is raising the statutory retirement age (Barr, 2012). The advantages of age targeting are easy identification of the eligible population and administrative simplicity, important in countries with low implementation capacity. The disadvantages are vertical leakages (benefits flow to people who are not poor), the crowding out of funding to other groups at risk of poverty (e.g. children) and regressivity, as the poor die younger than the rich.

Despite Kosovo's population being the youngest in Europe, rapid ageing (also a result of sustained working-age population migration) might pose a challenge in the medium- and longer-term (Table 5).

Table 5 Aged as % of total population

| Year | Age group | World | More developed | Less developed | Least developed | Kosovo |
|---|---|---|---|---|---|---|
| **1980** | +65 | 5.8 | 11.7 | 4.0 | 3.1 | - |
| **2015** | +65 | 8.3 | 17.6 | 6.4 | 3.6 | 8.0 |
| **2050** | +65 | 16.0 | 26.5 | 14.4 | 6.6 | 22.8 |

*Sources:* United Nations (2015); KAS (2016)[2].

A sensible solution is to link the statutory retirement age to life expectancy, which is precisely what the European Commission recommends. If this is done automatically, it also reduces the politicians' incentive to tinker with the system during periodical reviews (Schoyen and Stamati, 2013). As there is no silver bullet, beneficiaries have either to accept to save more, receive lower benefits, or work longer. The latter option is the most palatable, provided that the labour markets are ready to venture into uncharted territory.

**Benefits**

The Kosovar basic age pension was rather incorrectly categorized as ranking among the most generous. It errs on the profligate side, and yet, the disbursed benefits are only slightly higher than the recommended 15-20 percent of per capita GDP. So, it is not zero-pillar benefits that are problematic with regards to generosity. It is rather the other special pension schemes and inefficient disability assessment procedures that should be addressed first. As avoiding ad hoc increases by decree is paramount, all budget-financed benefits should be subject to systematic indexation.

[2] The projections for Kosovo refer to the years 2016 and 2051. All projections are based to either the UN or KAS medium variants. The UN divisions into more, less and least developed countries apply.

An important point for future consideration is the recipients' general perception that the basic benefit is modest compared to the costs of living. Given the high levels of indigence (circa 29.7 percent of the population lived under the national poverty threshold in 2011, according to World Bank data), the pension system shall play a prominent role in poverty alleviation, once its remaining problems are resolved and compatibly with budgetary capacity.

**Administration**

The interventions that may improve the efficiency of the Kosovar pension system include stricter residency requirements (partly introduced in the amendment to Law no. 04/l-131) and a consolidated social security database (more capacity duplication was instead recommended in the Concept Paper). First, although the basic and contributory pensions cannot be paid to the same person, the numbers do not add up. At the end of 2015, there were reportedly 172,365 recipients of basic and contributory pensions, against an estimated population aged 65 and above of circa 142,000. So, there may be as much as one-fifth of the cohort that are unlawfully receiving the basic pension. The IMF adduces four possible causes: individuals claiming both basic and contributory benefits; unreliable population estimates based on the 2011 census; non-declaration of deaths; and flaws in the concept of residency, both for benefit eligibility and for the census.

In order to improve the situation, residency requirements should be more rigidly enforced. This would mean that the recipients of old-age pensions should present themselves more often to the designated government agencies, lest they trigger a suspension of benefit disbursement, and that retroactive collection of benefits should be limited. As some NGOs deem this requirement as excessively burdensome, a partial solution may be to oblige, as some municipalities do, religious communities to report all burials, thereby enabling the immediate de-registration of all deceased from the lists of recipients (KSI, 2016).

Second, the administrative costs of the pension system should be reduced through a gradual integration of all social security payments, checks and tests with the tax administration as is the trend in many developing countries. Hence, a consolidated database of budget-financed cash transfers for individuals and households as well as of recipients, through the introduction of, e.g. a Danish-inspired Personal Identification Number (*CPR-nummer*) should be complemented by automated data exchange between the benefit database, the tax authority and financial service providers licensed to execute money transfers benefitting natural persons (Feher et al., 2016). This would serve the double purpose of reducing overall administrative costs and limiting the fruition of mutually incompatible benefits.

**Conclusions**

Consistent with the theoretical expectations on the clientelistic party competition in Mediterranean welfare regime, the Kosovar budget-financed pension system has undergone steady fragmentation since the international community relinquished authority to local politicians. If the original, World-Bank-inspired design espoused universalism as its defining feature, since 2008, a host of special schemes has sprung up, especially favouring the powerful constituency of war veterans.

In order to finance the costly and inequitable plans, the Labour Ministry planned to free up fiscal resources by limiting the coverage of the basic age pension. Due to its universalistic character, which reduces the potential for benefits clientelism, as well as low political and societal salience, the scheme represented a path of least resistance for retrenchment. The consequences of such reform would be dear: given Kosovo's socioeconomic reality, the planned measures might unnecessarily harm the poorest strata of the elderly population.

In line with IMF's proposals and the World Bank's current orientation, a more sensible solution would entail a mixed reform strategy that simultaneously tackles issues of: eligibility (a progressive linkage of the statutory retirement age with life expectancy); taxation (treating pensions as all other income and allowing recipients to continue working); benefit structure (keeping benefit levels and introducing systematic indexation); and administration (more rigidly enforcing residency tests and consolidating social security databases).

At the time of writing, the reform of the basic age pension has been stalled for some months. The unofficial reason is that the governing coalition between PDK and LDK is increasingly antagonistic, and incapable of solving the distribution of rewards between FARK and KLA veterans. Only the external intervention of the IMF, which imposed a cap on war-related and other special schemes under the threat of discontinuing the Stand-By Arrangement, is holding back such detrimental benefits clientelism.

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