

NEW LAW ON SALARIES: An examination of Potential Socio- Economic Effects

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NEW LAW ON SALARIES: AN EXAMINATION OF POTENTIAL SOCIO-ECONOMIC EFFECTS

I. Background

Public salary spillovers are considered an important component of the distribution of salaries, as a result may have influence upon the private sector. If the government offers a higher remuneration to its employees than the private sector, it may attract highly skilled workers and encourage unemployed to queue for public sector jobs.¹ This could lead to increases in taxes, higher budget deficits and/or diversion of public resources from productive uses. Such economic imbalance can reflect on the country's competitiveness, export performance, and economic growth at least in the medium-to long term.² If, alternatively, the public sector offers less competitive salaries than the private sector, the former might find it difficult to attract and retain well-qualified employees thus seriously impacting the quality of services provided by the public sector.³

The salary bill is one of the largest items in government budgets and as such it becomes an important instrument for the elected political elites, particularly during election cycles. The Government of Kosovo has unceasingly acted as an "employer of first resort," offering public sector jobs as a means of social support as well as social benefits. The number of employees in the public sector is estimated to be more than 81,550.⁴ Employment in the public sector (public administration, education and health) in Kosovo accounts for around 30 percent of total employment; however, the figure represented might be lower due to the existence of private sector in education and health.⁵

Growth of private sector on the other hand has not been sufficiently supported. The governments during this period have not pursued policies and structural reforms to support private sector growth and provide greater investor confidence. Despite some improvements in the business environment persistent challenges remain.⁶ Some of the main challenges include the widespread informal economy, lack of efficacy and efficiency of the judiciary, high prevalence of corruption as well as administrative barriers. The diversification of the economy is unsatisfactory, and the economy remains highly reliant on imports.⁷

Civil society organizations and media have constantly raised concerns for the lack of job security, and violation of labour rights such as employment without contracts, long working hours, and, amongst others, working extra hours (beyond 40 hours including weekends and holidays, without additional compensation).⁸ Besides that, the private sector is characterized by irregular payment schedules, non-payment of pension contributions as well as termination of employment without prior notice.⁹ It has been reported that the lack of job safety has been increasingly worrisome in certain industries, particularly in construction and heavy industry. On top of that,

¹ Shehaj E., Loxha, A., and Pula E. (2016). The Race for Public Sector Employment in Kosovo and Albania: What lies behind it?, Group for Legal and Political Studies. Policy Report. 12/2016

² Holm-Hadulla, F., Kamath, K., Lamo, A., Perez, J. J., & Schuknecht, L. (2010). Public wages in the Euro area. Towards securing stability and competitiveness (ECB Occasional Paper Series No. 112). Retrieved from European Central Bank website. <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp112.pdf>

³ Ibid

⁴ Draft concept document on the salaries that are paid by the Budget of the Republic of Kosovo. Accessed on March 2019 at: <https://konsultimet.rks-gov.net/viewConsult.php?ConsultationID=40275>

⁵ Kosovo Agency of Statistics (2015). Result of the Kosovo 2014 Labour Force Survey.

⁶ EC Country Report for Kosovo (2019). Available at: <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-kosovo-report.pdf>

⁷ Ibid

⁸ EC Country Report for Kosovo (2018). Available at: <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-kosovo-report.pdf>. Media reports <https://telegrafi.com/sektori-privat-prine-shkelje-te-te-drejtave-te-punetoreve/>; <http://rtv21.tv/a-po-shkelen-te-drejtat-e-punetoreve/>; <https://kosovotwopointzero.com/en/kosovos-privatization-of-workers-rights/>

⁹ KDI (2017). Punëtorët që s'kanë të drejta; Solidar (2011). Respect and Protection of Labour Rights in Kosovo. Available at: <http://www.solidar.org/en/publications/respektimi-dhe-mbrojtja-e-te-drejtave-te-punetoreve-ne-kosove-albanian>;

Labour Inspectorate and media reports have continuously reported numerous cases of workers that lost their life in the workplace.¹⁰

The budget of the Republic of Kosovo (henceforth the budget) on the other hand is mainly directed towards salaries, social schemes, and physical infrastructure. Salaries and per diems continue to hold a significant share of total expenditures. Since 2008, the public salary bill has increased almost three times faster than nominal GDP, and additional hiring in public sector has amplified the pressure on the government's expenditure on salaries. According to the Statistical Agency of Kosovo, the average gross salary in 2018 is reported to be €573 in public sector and €401 in private sector.¹¹ In addition, salaries in public sector considerably outpaced not only private sector salaries, but also public salaries in most of the neighboring countries, according to KAS data and IMF (2016). The average net salary in Kosovo in 2016 was the second largest (after Montenegro) across Western Balkan countries¹². Although many plans and strategies have been approved, budget priorities are not based on long-term plans and/or in-depth analysis. Hence, the budget continuously lacks characteristics of a development budget. The budget priorities are rather determined based on political interests and gains. Economic theory suggests that the primary factor determining the salaries paid to a worker is productivity. In the public sector, salaries have been influenced by political rather than productivity considerations (particularly in times of elections). This may lead to higher outcomes and, in turn, push public sector salaries up. Such salary policies against an environment of corrupt institutions and governance, and deficiencies in rule of law are ill advised. They promote and favour discretion and nepotism (hence inefficient hiring) and therefore *“discourage private employment, lowers productivity growth, hinders skill development, and unfairly benefits insiders who are able to obtain public sector jobs”*.¹³

In February 2019, the Assembly of Kosovo approved the Law on Salaries in Public Sector (LSPS) as one of the key laws included in the PAR package, along with the Law on Public Officials and the Law on Organization of Civil Service in Kosovo. The LSPS entered in force in November 2019. The new law is primarily initiated to ensure a more homogeneous adjustment to the issue of salaries, allowances, bonuses and benefits across the public sector. Although one of the key reasons for drafting a new law was to safeguard “the same salary for the same job” principle, there is a general agreement in the public that this has not been achieved. On the contrary, the new coefficients defined in the law have further increased the discrepancies and have triggered frustration and discontent amongst many categories of civil servants.

The new law has not been well received by all categories of civil servants.¹⁴ After receiving more than 35 complaints, the Ombudsman sent the law to the Constitutional Court on suspicion of constitutional violations and inequality in the public sector.¹⁵ The later has ruled on interim measures until 28 February 2020, approving the Ombudsman's request. The interim measure will be suspended following a constitutional ruling.¹⁶

¹⁰ Labour Inspectorate (2018). “Annual Report of the Labour Inspectorate for 2018”, Available at: <https://ip.rks-gov.net/wp-content/uploads/Raporti-12-Mujor-2018-.pdf>; Labour Inspectorate (2017), “Annual Report of the Labour Inspectorate for 2017”, Available at: <https://ip.rks-gov.net/wp-content/uploads/Raporti-i-Punes-per-vitin-2017-nga-Inspektoriati-i-punes-2.pdf>; Telegrafi (2019). Lëndimet dhe vdekjet në vendin e punës gjatë vitit 2018-2019, punëtorët në mëshirën e fatit. 08 prill, linku: <https://telegrafi.com/lendimet-dhe-vdekjet-ne-vendin-e-punes-gjate-vitit-2018-2019-punetoret-ne-meshiren-e-fatit/>

¹¹ Kosovo Agency of Statistics (2019). Salaries in Kosovo during 2012-2018.

¹² Kosovo Agency of Statistics (2017). Salaries in Kosovo during 2012-2016. The average net salary is reported to be 499 in MNE; 457€ in KS; 375€ in AL; 372 in MKD; 374 in SRB and 428 in BiH.

¹³ Tamirisa, N. and Duenwald, Ch. (2018). Public Salaries Bills in the Middle East and Central Asia. IMF Library. pp.3 Accessible at: https://www.elibrary.imf.org/view/IMF087/24860-9781484336731/24860-9781484336731/24860-9781484336731_A001.xml?language=en&redirect=true

¹⁴ <https://www.koha.net/arberi/197774/ligji-per-paga-trazon-punetoret-e-sektorit-publik/>

¹⁵ Available at: <https://www.oik-rks.org/2019/11/20/>

¹⁶ See the Constitutional Court Decision: <https://gjk-ks.org/decision/vleresim-i-kushtetutshmerise-se-neneve-te-caktuara-te-ligjit-nr-06-l-114-per-zyrtaret-publik/>

This policy analysis aims to discuss some of the potential implications of the increase in salary bill and private sector that result from the new Law on Salaries in Public Sector. First, the analysis provides an overview of the trends in public sector salary and it offers a comparative perspective between public and private sector. More precisely, it examines the effect that the new Law on Salaries may have on the budget, fiscal sustainability, private sector, and the potential socio-economic impact.

II. An overview of the trends in the public sector salaries

Enormous increases in the public sector salaries in post-independence period have been evident. The Government of Kosovo has, in a discretionary way, used public sector salaries for political gains. In 2008, the Government raised salaries in public education sector approximately 10-47%, depending on the level of educational attainment.¹⁷ Another increase of a 50% on base salary preceded the 2011 elections.¹⁸ This led to an increase in the total salary bill of approximately 13% each year during 2008-2016 period.¹⁹ The Government, once again, increased salaries in the public sector by 25% of the basic salary in 2014²⁰, just before parliamentary elections. These increases have not been accompanied by corresponding gains in labor productivity (IMF, 2019).²¹ In January 2018, another Government decision increased salaries in public sector by 4%. The last Government decision of this sort was recorded in 2019 when the then Prime Minister decided to increase his own salary, his Cabinet's, and government advisors'.²² This decision automatically led to an increase in the salaries of the judges and prosecutors.²³

In fact, salaries in the public sector have followed an increasing trend since 2007 (Table 1). According to Kosovo Agency of Statistics (KAS) the average gross salary has gradually increased from €199 in 2007 to €573 in 2018 - more than a triple increase in nominal terms. This increase has considerably outpaced the private sector salaries and in some cases public salaries in neighboring countries (IMF, 2016). Besides, increases in salaries are argued to have resulted in increase in average inflation rate (Table 1).

¹⁷ <http://kryeministri-ks.net/qeveria-e-republikes-se-kosoves-ka-aprovuar-vendimin-per-rritjen-e-pagave-per-personelin-mesimdhenes-dhe-jomesimdhenes-ne-shkollat-e-republikes-se-kosoves/>

¹⁸ Government decision No.01/151 of January 6th 2011. Available at: http://kryeministri-ks.net/wp-content/uploads/docs/Vendimet_e_mbledhjes_151_te_Qeverise_2011.pdf

¹⁹ IMF Country Report No. 16/22. January 2016.

²⁰ <https://www.gazetaexpress.com/lajme/zyrtare-pagat-rriten-25-per-qind-2456/?archive=1>

²¹ As far as the direction of causality is concerned, the main theoretical reference is the so-called Scandinavian model of salaries determination (Aukrust [1970]). This model assumes that the sector that is open to international competition is the leader in salaries setting since productivity should increase faster in the traded goods sector and firms there cannot increase salaries above productivity in order to avoid losing competitiveness

²² Government Decision No. 01/20. Available at: http://www.kryeministri-ks.net/repository/docs/Vendimet_e_mbledhjes_se_20.pdf

²³ See for more: Law No. 03/L-225 for the State Prosecutor and the Law on Judiciary 03/L-199 and the article published in Insajderi portal available at: <https://insajderi.com/pas-rritjes-se-pagave-ne-qeveri-rritje-automatike-e-pagave-edhe-ne-gjykata-dhe-prokurori/>

Table 1. Salaries in public sector during 2007-2018 period

Year	Average gross salaries in public sector (€)	Increase (%)	Occurrence of salaries increases	Elections	Average Inflation
2007	199	2.05	No	17 November 2007	4.3
2008	211	6.03	Yes (August)		9.3
2009	270	27.96	No		-2.4
2010	310	14.81	No	12 December 2010	3.5
2011	368	18.71	Yes (January)		7.3
2012	407	10.60	No		2.5
2013	415	1.97	No		1.8
2014	465	12.05	Yes (March)	8 June 2014	0.4
2015	511	9.89	No		-0.5
2016	525	2.74	No		0.3
2017	532	1.33	No	11 June 2017	1.5
2018	573	7.7	Yes (January) ²⁴		1.1

Source: Kosovo Agency of Statistics and authors calculations

A further comparison between public and private sector salaries is depicted in Table 2. Data suggests that salaries in the public sector during 2012-2018 period increased by around 40%, respectively from €407 in 2012 to €573 in 2018. The private sector on the other hand, experienced only a 9% increase. Such discrepancy indicates a continuous increase on the wage gap between these sectors during this period. The gap is even higher between salaries in the private sector and public enterprises (as suggested in Table 2). The average salary in public enterprises is around €300 higher than that in private sector or around 74% higher.

²⁴ Available at: <https://kryeministri-ks.net/qeveria-e-republikes-se-kosoves-miratoi-vendimin-per-rritjen-e-pagave-per-4-per-te-gjithe-te-punesuarit-qe-marrin-paga-nga-buxheti/>

Table 2. Comparison of gross salaries and their increase across sectors during the 2012-2017 period

Year	Gross Salaries in Public sector (€)	Salaries increase (%)	Gross Salaries in Public Enterprises (€)	Salaries increase (%)	Gross Salaries in Private sector (€)	Salaries increase (%)
2012	407	-	518	-	367	-
2013	415	1.97	549	5.65	367	0
2014	465	12.05	624	12.02	358	-2.45
2015	511	9.89	651	4.15	367	2.51
2016	525	2.74	660	1.36	371	1.09
2017	532	1.33	667	1.05	384	3.50
2018	573	7.7	699	4.9	401	4.42

Source: Kosovo Agency of Statistics, Salaries in Kosovo data.

III. The New Law on Salaries: implications on the budget, private sector and potential socio-economic impact

The overall civil service remuneration system in Kosovo has lacked simple structure. The LSPS, formally in force until February 2019, was not being implemented due to budget deficiencies. This law applied only to civil servants (around 18,000) and did not cover other categories of employees in public sector that receive direct salaries from the Kosovo budget. A total of 58 legal documents regulated the remuneration system in individual institutions.²⁵

Most institutions adopted a distinct salary scheme, other than the coefficient of determination in the civil service.²⁶ Similarly, some institutions adopted the civil servant status as stipulated by law yet, defined their own payment schemes, given -as they articulate- the specifics and nature of the scope of work of the institution or agency. Salary supplements for civil servants were limited, and also not clearly defined. As a result, similar positions were rewarded with different salaries, and disparate and contrasting salaries were evident in sectors of similar importance.²⁷

As explained earlier, the new Law on Salaries in Public Sector has been approved by the Assembly and it aims to ensure a more homogeneous adjustment to the issue of salaries, allowances, bonuses and benefits across the public sector. It determines the salary and reward system for the Public Officials and Officers paid from the state budget, except for Kosovo Police and Security Forces. In addition, it provides the minimum rules for determining salaries of employees of public enterprises in Kosovo. It furthermore defines the criteria for the transitional

²⁵ Meeting with officials of Ministry of Public Administration, March 2019.

²⁶ GAP Institute (2016). Institutions and Independent Agencies: Labour Relationship, Salary System, Internal Organization and Accountability. Available at: https://www.institutigap.org/documents/77948_Agjencionet%20e%20Pavarura.pdf

²⁷ Meeting with officials of Ministry of Public Administration, March 2019.

salary and other benefits after the end of public term, or for public officials with a special status. The base salary is determined based on the rank of the position and the coefficient. The new law defines 11 classes of positions (A, B, C, D, E, F, G, H, P, L and M) across 69 coefficients ranging from a value of 1-10.²⁸ The lowest coefficient, with a value of 1 amounts to a salary of € 239 whereas the highest salary is that of the President with a coefficient of 10, respectively €2,390.

Moreover, the law addresses the issue of salary supplements which have been abused in the past. It defines the types of salary supplements and the maximum amount of supplement that can be received in relation to the base salary. More precisely, it stipulates four types of salary supplements: a) market conditions; b) performance; c) extra work or compensation for overtime work and d) special supplements. The supplements can amount to a maximum of 40-50% of the salaries, depending on the type.

The new law has resulted in considerable increases of the base salaries in several sectors such as: education (all levels including higher education), health, judiciary, president, prime minister, government cabinet, mayors and army. The salary of the highest paid positions such as the President and the Prime minister is respectively 16 and 14 times higher than the minimum salary and 6 times higher than average salary in private sector.²⁹

According to an IMF representative in Kosovo:

“only the increase in basic salaries will cost about 80 million euros. For 2019, the cost will be manageable, as the law will not come into effect until November 2019. The budget for 2019 foresees an increase in the budget allocation for salaries of about 26 million euros, which is slightly below the permissible allowance according to the salary allocation rule. This rule, which is supposed to prevent the rise of public sector salaries faster than the economy itself (GDP growth) has come into effect last year. We [IMF] do not see any immediate danger from the salaries allocation rule in 2019.”³⁰

In 2018, the salary bill amounted 590 million euros whereas the Law on Budget for 2019 dedicated 620 million euros. With the new LSPS, it is estimated that in 2019 the wage bill will be around 730 million euros³¹, which is 23% higher than the previous year. Consequently, fiscal rule will be violated.³² To date, the Government has not published an estimation of the impact of the new Law. One thing is for sure: the wage bill will increase and the impact on the budget is going to be higher.

IV. Implications

The increase in the salary bill of the public sector is expected to have several implications for the economy. Whether some or all of the theoretical assumptions will hold, it is to be seen. Stronger considerations could however be drawn from an empirical perspective. Regardless, this section lists some of the potential implications of the increase in the salary bill that could derive from the

²⁸ The Law on Salaries, Appendices 1 and 2.

²⁹ <https://zeri.info/ekonomia/209373/projektligji-per-pagat-se-shpejti-procedohet-ne-qeveri/>

³⁰ Available at: <https://telegrafi.com/fmn-e-shqetesuar-ligjin-per-pagat-viti-2020-problematik/>

³¹ According to IMF representative, the increase in salaries with the new law will cost 80 million euros.

³² Radio Evropa e Lire. FMN e shqetesuar me Ligjin per Pagat, viti 2020 problematik. Accessed at: <https://www.evropaelire.org/a/fmn-e-shqetesuar-me-ligjin-per-pagat-viti-2020-problematik/29757687.html>

LSPS. It is expected to have a budgetary, fiscal and socio-economic impact, also on the private sector.

Budgetary and fiscal sustainability implications

The economic growth, according to the Central Bank of Kosovo (CBK) and the Law on Budget for 2019, is expected to be 4.2% in 2019. According to the World Bank estimations, growth rate in Kosovo is estimated to be on average 4.1% during 2019-2021 period.³³ Overall Kosovo production capacities are largely underdeveloped and growth is fuelled mainly by consumption, public infrastructure investments, higher exports in services and remittances.³⁴ Nevertheless, a stronger and higher-quality growth is required in order to assure employment.³⁵

Budget revenues on the other hand are dependent on custom revenues and taxes. Kosovo lacks a production base and is largely dependent on imports, which explains the large trade deficit (despite slight improvements). Expenditures on salaries as well as social benefits continue to hold a significant share of total expenditures. The Law on Budget for 2019 has foreseen around 620 million euros expenditures on salaries hence accounting for around 30% of the overall budget.³⁶ The budget revenues are estimated to be 1.8 billion euro, whereas expenditures are estimated at 2.3 billion euro. The governments in the past declared to be committed to adhere to the fiscal rules, but spending pressures resulting from increased social benefits for specific groups of the population and public employees' wages, risk jeopardizing public finances and hindering private sector development. In other words, budgetary implications due to the increases of salary bill would necessitate increase in the tax rate, decrease in capital investment, and increase in public debt.

First, provided this growth perspective prevails, an increasing salaries participation in the country's budget will undeniably initiate pressure for ***an increase in tax rates***. Similarly, the latest report of Central Bank (CBK) suggests that external debt for 2019 amounts to 1.1 billion €. According to IMF projections, the external debt is estimated to double, from 1,189 in 2018 to 2,452 million euros in 2023.³⁷ Growth of the budget deficit would undoubtedly lead to an increase in the tax burden (by involving changes in the tax rates) taking into account the necessity to collect more revenue.

Second, a large and increasing salary bill would be at the expense of a decrease in capital investments in priority sectors that are of great importance in terms of strengthening the private sector and promoting economic growth.³⁸ As a result, it risks deepening the budget deficit.

Third, Kosovo would have to increase public debt (in addition to possibly increasing tax rates) in order to finance increased a salary bill and social schemes in the upcoming years and to maintain and even increase the much needed capital investments (beyond physical infrastructure). According to World Bank, public debt in Kosovo could reach up to 30 percent of GDP by 2025, if current spending growth continues to exceed revenue growth.³⁹

³³ The World Bank (2019). Western Balkan Regular Economic Report: Rising Uncertainties. Nr. 16. Accessible at: <http://documents.worldbank.org/curated/en/643781570478210132/pdf/Rising-Uncertainties.pdf>

³⁴ The World Bank (2018). Country Snapshot. Accessible at: <http://pubdocs.worldbank.org/en/222151539289515672/Kosovo-Snapshot-Oct2018.pdf>

³⁵ Ibid

³⁶ LAW NO. 06/L -111 ON SALARIES IN PUBLIC SECTOR, Available at: <https://gzk.rks-gov.net/ActDetail.aspx?ActID=18683>

³⁷ IMF (2019). 2018 Article IV Consultations—Press Release; and Staff Report.

³⁸ Tamarisa, N. and Duenwald, Ch. (2018). Public Salaries Bills in the Middle East and Central Asia. IMF)

³⁹ The World Bank (2019). Western Balkan Fiscal Rules Overview. Working Paper Series WPS8990. Accessible at: <http://documents.worldbank.org/curated/en/596371564661398986/text/Wester-Balkans-Fiscal-Rules-Overview-Paper.txt>. "In 2016, this deficit rule was relaxed by excluding investment spending financed by foreign

Private Sector Implications

The salary gap is currently in favor of the public sector, and the gap will be further widened with the entry into force of the new law; unless private sector reacts with an increase in salaries; although it is highly unlikely. The gap between the two sectors motivated by productivity increases is argued to motivate the private sector to develop and perform better.⁴⁰ As already established throughout this study, salaries in the public sector in Kosovo have increased at a rapid rate over the last decade. When considering the job security and fringe benefits that the public sector offers, the attractiveness of the public sector is expected to boost the new law. The attractiveness of the private sector on the other hand will further deteriorate, demotivating individuals to look for jobs in the private sector.

On another note, the proliferation of political influence in recruiting public officials hampers the independence and accountability of the recruitment process by giving priority to political loyalty over the quality of service delivery. Therefore, the public sector may fail to retain well-qualified employees. This suggests that the theoretical expectations of higher salaries (in the public sector) attracting highly qualified employees may not necessarily hold. In other words, educated individuals may end up in the private sector despite the pay gap in favor of the public sector. They may also end up doing low-skilled jobs due to the high unemployment rate.⁴¹

Furthermore, increased salaries in public sector can influence private sector salaries by increasing reservation salaries and crowding out private sector employment as it may be complicated to find qualified workers. The private sector is unable to follow the pace of institutions in salaries growth, as salaries in this sector are determined by market forces and labor productivity. According to official data, a considerable share of the population is economically inactive (around 60%).⁴² Unattractiveness of the private sector, low salaries – particularly in comparison to the public sector- and the conditions it offers are arguably some of the reasons behind it. This seems to be already the case. According to a research published by the GAP Institute's on vocational training for the labor market in the service sector *"92 percent of surveyed companies employed new workers during the last three years, of which 82 percent have encountered difficulties in finding skilled workers."*⁴³ The mismatch of labour market supply with business requirements has forced the latter to hire less skilled workers, which is believed to have affected new service development and productivity decline.

donors and privatization proceeds. This investment exemption, which expires at the end of 2025, applies only while the debt of general government is below 30 percent of GDP (article 7 of the law of 2015 amending the Law on Public Financial Management and Accountability)."

⁴⁰ Shehaj, E., Loxha, A., and Pula, E. (2016). The Ract for Public Employment in Kosovo: What Lies Behind It. Policy Report 12/2016, Group for Legal and Political Studies.

⁴¹ Ibid

⁴² Kosovo Agency of Statistics (2019). Labour Force Survey Results 2018.

⁴³ GAP Institute (2017). Professional qualifications for the job market: Analysis of the private service sector. pp. 17. Available at: https://www.institutigap.org/documents/92823_Professional%20qualifications%20for%20the%20job%20market%20Analysis%20of%20the%20private%20service%20sector.pdf

Socio-economic and Welfare Implications

Sizable public sector⁴⁴ and increased salaries may favour vested interests. The new law will further increase the attractiveness of public sector and as a result, increase the bargaining power of the political elite over the mass. The competition for employment in the public sector will further increase, thus enabling the political elites to instrument the youth in particular (considering the high unemployment rate amongst them). Consequently, this contributes to further nepotism in the civil service recruitment procedures, and hence further undermines the merit-based recruitment and transparency.

Another implication of the law concerns social inequality. On this note, inequality may be manifested not only based on salary gap but also due to inflation. By increasing aggregate demand, a high salary bill results in inflation, which then itself may result in increasing inequality, and undermining economic growth and job creation.

In this context, prices may also increase for at least two reasons: First, the private sector could be forced to increase salaries as well in order to retain workers. Second and more importantly, the money supply of consumers (consumer spending) will increase as well. Theoretically this means consumers have higher spending power, so the demand for goods increases. However, considering that citizens' spending is mainly directed towards consumption⁴⁵, it suggests that demand will mainly be directed at non-productive sectors and is therefore unstable. As a result, it will increase imports while exports will remain almost the same due to no increase in output. This indicates that the increase in salaries does not guarantee an improvement in social welfare. Quite to the contrary, a potential increase in prices driven by hyper consumption is expected to increase the cost of living. The effect can be argued to be most prevalent on private sector employees as the purchasing power decreases due to an increase in prices and no changes in their salaries.⁴⁶ Worryingly, the heaviest burden will weight on the low-income households and the unemployed, leading to further social and economic inequality.

On the other hand, the increase in prices will also affect (decrease) the purchasing power of public sector employees, although to a lower extent. The high growth of increased social spending (as it is the case with Kosovo) and wage bill have had an immediate effect on rates of economic growth in some countries; resulting from rapid rise in consumption and credit to households.⁴⁷ Nevertheless, the positive effects will be temporary and costly in the long term as such spending increase fiscal vulnerability due to being a high burden on the budget.

V. Conclusion

For a long time, the remuneration system in the public sector has been highly defragmented. The previous Law on Salaries was not all encompassing for the public sector and was often not implemented due to budget deficiencies. Instead, a total of 58 legal documents were used to regulate the remuneration system for individual institutions. Therefore, addressing this issue was eminent. In this regard, in February 2019, the Assembly of Kosovo approved a new Law on Salaries in Public Sector as one of the key laws included in the Public Administration Reform package. The

⁴⁴ Approximately 80,000 individuals are paid from the budget of the Republic of Kosovo. See for more details: <https://mf.rks-gov.net/Page.aspx?id=1,2,428>

⁴⁵ According to the 2018 Annual Report of the Central Bank of Kosovo, consumption is the main component of domestic demand.

⁴⁶ Wages push inflation has an inflationary spiral effect that occurs when wages are increased and businesses must — to pay the higher wages — charge more for their products and/or services.

⁴⁷ The World Bank (2018). The regular economic report for Western Balkans. A higher economic growth but fragile. No.14. Accessible at: <http://pubdocs.worldbank.org/en/470311538669100475/WBRER14-web-ALB.pdf>

new law was set to ensure a more homogeneous remuneration system that safeguards “the same salary for the same job” principle.

In a nutshell, the new law provides the minimum rules for determining salaries of employees in public sector, defines the criteria for the transitional salary and other benefits after the end of the public term, and clarifies types of salary supplements and the maximum amount of supplements that can be received in relation to the base salary.

The restructuring of the remuneration system by the new law brought about a considerable increase of the base salaries in several sectors such as education, health, judiciary, president, prime minister, government cabinet, mayors, and army. This increase is estimated to amount the 2019 salary bill up to 730 million euros, which is 23% higher than the previous year. Nonetheless, despite the approval of several plans and strategies by the Government, currently there are no official estimates or studies that evaluate the cross sectorial impact of the new law.

This said, this policy analysis examined some of the potential implications that this law may have on budget and fiscal sustainability, private sector, and the potential socio-economic and welfare impact. On matters pertaining to the budget and fiscal sustainability, this analysis argues that because of Kosovo’s dominating economic characteristics, an increase in salary bill may be cause for an increase in tax rates, a decrease in capital, and an increase of public debt. Regarding implications for the private sector, it argues that it can lead to a salary gap in favour of public sector as opposed to private sector, leading to demotivation of individuals to look for jobs in the private sector. This may also influence the private sector salaries by increasing reservation salaries and crowding out private sector employment as it may struggle to find qualified employees. On the other hand, if current political influence in recruiting public officials remain intact, the public sectors may fail to retain well-qualified employees, marking no improvements whatsoever regarding service delivery. This goes against the expectation that higher salaries in the public sector will attract well-qualified employees. Lastly, it argues that the new law has also strong implications for the social-economic and welfare domain. The increase in salaries may lead to inflation, which as a result may lead to further social and economic inequality. Such effect can be argued to be most prevalent on private sector employees as their purchasing power decreases due to the increase in prices and no change in salaries. Worryingly the heaviest burden will be placed on the lower income households and the unemployed.

Overall, the government should have considered such implications and the new government should take the issues, that derive from the implementation of this law, into account.

Policy Analysis

Policy Analysis in general is a policy advice paper which particularly aims to influence the key means through which policy decisions are made in both local and central levels of government. The purpose of Policy Analysis is to address, more in-depth, a particular problem, to examine the arguments related to a concerned policy, and to analyze the implementation of the policy. Through Policy Analysis, Group for Legal and Political studies seeks to stimulate wider comprehensive debate on the given issue via presenting informed policy-relevant choices and recommendations to the key stakeholders and parties of interest.



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