

Efficient allocation of resources for decentralised provision of social services in Kosovo

Discussion paper for development of a budget formula №1

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Authors:

Laurie Joshua

Yuriy Dzhygyr

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Acronyms and Abbreviations

CFA	Central Fiscal Authority
CoE	Council of Europe
CSW	Centre for Social Work
DLA	Department of Local Administration
EC	European Commission
EU	European Union
FQSSDS	Functional and Qualitative Social Services Delivery Survey
GND	Inter-ministerial Group on Decentralization
GOK	Government of Kosovo
HES	Household Expenditure Survey
IMF	International Monetary Fund
LLGF	Law on Local Governemnt Finance
LLSG	Law on Local Self-Government
MDHSW	Municipal Departments for Health and Social Welfare
MEF	Ministry of Economy and Finance
MLGA	Ministry of Local Government Administration
MLSW	Ministry of Labor and Social Welfare
MoU	Memorandum of Understanding
MTEF	Medium-Term Expenditure Framework
NGO	Non - Governmental Organizations
PER	Public Expenditure Review
PISG	Provisional Institutions of Self-Government
SCS	Social Care Services
UNMIK	United Nations Interim Administration Mission in Kosovo
VAT	Value Added Tax
WB	World Bank

Issue

The system of social care services in Kosovo is under pressure for a significant change.

The MoUs signed in February 2009 between the MLSW, MLGA, MEG and Kosovo Municipalities marked the beginning of a transition towards provision of social care through an improved, decentralised, more efficient framework (1). This reform has put to traction the vision outlined in the Ahtisaari Plan in 2007 for social welfare services which would be strongly governed, efficient, and ensure fair and equal protection of all community members from social risks and vulnerabilities. The Ahtisaari Plan acknowledged that such efficiency and fairness should be achieved through decentralization of social care for the vulnerable to the municipal level (2). The 2009 MoU made the first step in this process by putting responsibility for SCS on to municipalities and transferring a share of administrative functions to municipal administrations (most importantly, the CSWs).

However, the administrative restructuring and partial decentralisation of 2009-2010 brought to light the numerous remaining and arising challenges to reform. Gradual approach to decentralisation contributed to a situation when financial and policy decision-making for social service provision became split between the tiers of government, making it difficult to effectively exercise policies to improve social service provision:

- **The bulk of the existing social services remain fully or essentially centralised.** This includes residential services to elderly, adults and children with disabilities (fully centralised); social services provided by the NGOs (fully centralised); and benefits for foster care and families with children with permanent disabilities (deconcentrated) (3).
- **Social services which were decentralised have retained elements of managerial or financial subordination to central authorities.** As was discussed in detail in this project's Inception Report, decentralised CSWs find it difficult to provide social services in a systemic way based on local needs, given the financial, administrative and managerial demands placed on them by the central authorities. The units of CSWs responsible for social assistance still receive their wages from the MLSW, and the units of CSWs responsible for professional social welfare are mainly engaged in the administration of payment schemes for foster care and families with children with permanent disabilities and have little capacity to provide further social services (3). Moreover, the MDHSWs which are responsible for planning, budgeting and monitoring of the local SCSs, share a healthcare policy function with the Ministry of Health and often favour health aspects before provision of SCSs. Finally, according to the current legislative framework, local governments are not allowed to use own-source revenues to cover salary costs and therefore have low marginal fiscal autonomy (the freedom to allocate additional revenues) to fund SCSs under their responsibility, which contributes to central financial constraints in delivering these services (3).
- **Transfer of responsibilities to other levels of governments highlighted the problem of weak coordination between economic and functional budget classification.** The transfer of CSWs to municipal responsibility illustrated the difference between budget-funded organisations and public functions. The CSWs are responsible for a range of tasks some of which were delegated to municipal level (social welfare) and others deconcentrated, such as administration of social assistance payments or foster care benefits. This raised the question of funding for the salaries of respective staff, some of which remained covered by the MLSW while others had to be, theoretically, transferred for financing from the municipal budgets (3).
- **Transfer of responsibilities between levels of government highlights emergent problems of weak coordination between stakeholders in social service policy making.** Already in 2006, there was evidence that stakeholders are quickly building their managerial and coordination skills: e.g., the MDHSWs – being relatively young organisations – have created their own association and an institutional readiness to respond to social needs of the population (4) (5). However, responsibilities of MDGHSWs are not yet clearly shaped and often tilted towards health issues, coordination between MDGHSWs, CSWs, local authorities and NGOs still have to develop. The latest in-depth analysis in 2006 (which is

admittedly outdated and needs verification) noted that at the time the CSWs were more responsible to the priorities of the MLSW than the needs of other municipal departments working with the people in need; and at the same time the complex role of the CSW was not properly understood at the municipal level with many municipal departments thinking of the CSW mostly as of administrators of social assistance benefits rather than providers of social services to vulnerable population groups. Same analysis pointed that all stakeholders involved in social service provision need significant further capacity building for joint policy planning and implementation, which lies at the heart of the added value from decentralised service provision (5).

- **Lack of clarity over financing of decentralised CSWs creates risks of a dry spell in 2012 which may be detrimental in the long-run.** Financial arrangements for covering decentralised service provision reflect the society's choice over how responsibility for this function is shared across tiers of government. Specific central transfers tend to indicate stronger responsibility of the central government and lower local autonomy over how to provide services. On the other hand, block grants symbolise more significant decentralisation, when local authorities receive freedom and flexibility in re-directing funds across programmes, but entail respective risks that the central government would not be able to guarantee full and exact coverage of specific public services (so, such arrangement normally requires more complex reforms to ensure that standards of services and audit systems are in place to minimise these risks). The choice of intergovernmental funding mechanism for CSWs remains uncertain. After a year of specific grant funding (which, essentially, reproduced the centralised funding scheme in the absence of a reformed approach), the Government is considering inclusion of these costs into the General Grant for 2012. As we discuss further in this paper, under the current institutional conditions, this decision may lead to significant short-term reduction of funding for social services, creating long-term risks for their development.

The current dynamically changing framework for social service provision raises several analytical challenges in the area of intergovernmental finance:

- **The Government will need to develop a financial mechanism for funding social services which would include transitional rules and mechanisms for gradual decentralisation.** Given the complex change management agenda outlined above, decentralisation of social services in Kosovo is likely to be, on the one hand, politically inevitable and ambitious, and, on the other hand, it will not happen overnight (6) (7). As needed capacities and systems develop at both levels of government, and functions are transferred gradually to the municipalities, Kosovo will have to live through some years of transitional arrangement. To capitalise on the opportunities of this process, and to avoid the risks of transition (which are already visible), the Government will need a clear consensus on the ultimate vision for reform and a robust financial toolkit, including carefully designed transitional elements of the budget formula, to run through the reform years.
- **Financial rules for allocating resources on social service provision will need to take into account political economy of the reform.** Given the strong political background of the decentralisation process in Kosovo, and the importance of efficient and fair system of protection against social vulnerabilities for the country's long term future, the reform should be designed with careful consideration of its potential gainers and losers; the expected distribution of its benefits across communities; and its long-term financial sustainability. Addressing these strategic questions requires detailed statistical simulations of the consequences of various scenarios of decentralisation, and of the different options for the intergovernmental transfer formulae for social services.

This discussion paper brings together an analytical framework for the decisions that will be made regarding intergovernmental allocation of resources for social care services in the process of their decentralisation. The paper sets a methodological platform for designing respective budget formulae and outlines requirements for statistical analysis and data simulations which would inform and support the choice of transfer allocation criteria at various stages of the decentralisation process.

Summary of background information

Political economy of decentralisation reforms

Political determination for significant decentralisation of governance in Kosovo is one of the core achievements of the post-conflict years. One of the Kosovo's extraordinary achievements through the challenging post-conflict years has been its determination to build a democratic multi-ethnic society "based upon the equality of all citizens and respect for the highest level of internationally recognized human rights and fundamental freedoms, as well as the promotion and protection of the rights and contributions of all its Communities and their members" (2). The 2007 Ahtisaari Plan has proposed decentralisation as one of the key vehicles to achieve this vision. The Comprehensive Proposal for the Kosovo Status Settlement put forward within the Ahtisaari Plan assumed a wide-ranging decentralisation agenda, aimed at building a system of public services which would be transparent, efficient, and capable of addressing the legitimate concerns of all Communities that are not in the majority in Kosovo and their members, and ensure their active participation in public life.

Decentralisation agenda in Kosovo builds on the strong tradition of local governance and self-management.

- Between 1960-1987, Kosovo functioned under the status of an autonomous province within the former Yugoslavia. Although the status sometimes had more formal than practical implications for local autonomy, this arrangement – coupled with the Tito's Yugoslavia's relatively more democratic approach to intergovernmental relations compared to other planned economies – helped Kosovo to develop a tradition of decentralised governance and institutional experience of running a multi-layer governance system (6).
- This tradition was challenged by the subsequent pre-war years of centralisation and nationalisation, as local governments lost control over local property and decision-making powers over public expenditures. While local authorities were formally responsible for a wide range of functions, their spending decisions were actually strictly controlled by the central government (6).
- However, observers point that these difficult years of a police-state actually helped Kosovo to rejuvenate its tradition of self-management, because the way Kosovo society reacted to the authoritarian challenge was through development of a system of parallel institutions and thus taking local control. This evidence also points that this inclination towards self-management is visible in various spheres of public life in Kosovo, with "various boards, e.g. school boards, and committees, e.g. regulatory bodies, at the local and national level operating according to a social self-management model" (6), which makes Kosovo favourably different from many other decentralising countries in the region.

Political priority of decentralisation creates opportunities, as well as risks for successful reform.

- Decentralisation of public service provision can help to simultaneously serve two purposes. It can help to improve relations between communities by giving them more autonomy over how to spend public budgets, as well as improve the efficiency of service delivery by giving communities more choice over the scope and menu of services they receive.
- However, delivering services through a multi-layer governance system is often a more complicated task (compared to centralised arrangements), which requires stronger financial management, more advanced planning capacities at all levels, and, most importantly, it places more demands on skills for working in partnerships that involve a

number of different organisations and actors, horizontal cooperation, and policy dialogue. To integrate societies and improve services, decentralised service provision systems need to be inclusively designed, robustly funded and carefully tested. On the other hand, failure to acknowledge the interests of some stakeholders and financing gaps or mismatches generates risks which can create institutional stresses that destabilise multi-layer structures (8).

- While strong political impetus towards decentralisation may provide a necessary momentum to reform, and help stakeholders achieve consensus, there is also risk that decisions are taken or enacted without proper consultations, data simulations and scenario analysis. Observers in fiscal decentralisation note that “no matter how the decentralisation will be decided on the political level, its implementation will be a significantly challenging and long-term process. It will take a few years’ time to establish functioning, efficient, accountable, transparent and financially sustainable new municipalities” (6).

Political vector for decentralisation of public services – and specific commitment for decentralisation of social services – originates from (a) the Status Process and the Ahtisaari Plan, as well as (b) Stabilisation and Association Process and the European Partnership.

1) Status Process and the Ahtisaari Plan (2007). Guidelines for decentralisation of public services – including specific guidelines for social services – were established in the Ahtisaari Plan (Arts. 3, 4, 5, 6 and 12.2 Annex III) (2) and developed in the subsequent legislation. It is notable that the Ahtisaari Plan contained not only a general direction and reasoning for political decentralisation, but also very concrete commitments concerning transfer of responsibilities for social care services to municipal level, as well as concerning financial instruments to fund these transferred competences. These guidelines are summarised below.

General approach to decentralisation	<ul style="list-style-type: none"> ▪ Outline of political and economic reasons for extensive decentralisation; ▪ Description of intended framework for decentralised service provision and its financing, including: <ul style="list-style-type: none"> - Basic principles - List of laws to be approved (and timeframe); - Definition and detailed list of Municipal Competences (including Enhanced Competences) and Delegated Competences; - Principles of Local Finance, Inter-Municipal Cooperation, co-operation with Institutions in the Republic of Serbia; - Plans on establishment of new municipalities.
Social services	<ul style="list-style-type: none"> ▪ Commitment to include into Municipal Competences “full exclusive powers insofar as they concern the local interest while respecting the standards set forth in the applicable legislation” in the area of “Provision of family and other social welfare services, such as care for the vulnerable, foster care, child care, including registration and licensing of these care centres, recruitment, payment of salaries and training of social welfare professionals”. (Annex III / Art.3-j).
Social assistance	<ul style="list-style-type: none"> ▪ Commitment to include into Delegated Municipal Competences responsibilities over distribution of social assistance payments (Annex III / Art. 5-e).

Spending autonomy	<ul style="list-style-type: none"> ▪ Commitment to provide Municipalities with “the right to determine the structure and size of their own budgets covering tasks falling within their competences”. (Annex III/ Art. 8.1).
Division of revenues	<ul style="list-style-type: none"> ▪ A principle that taxes will be strictly divided between tiers of governance: some revenues will remain local (such as property tax), while a defined list of revenues will be centralised (such as VAT, income taxes, and custom duties) (Annex III / Art 8.2;
Central grants	<ul style="list-style-type: none"> ▪ General direction to finance Municipal Competences through a fair and transparent Block Grant system. Ahtisaari Plan specifically calls for a revision of the previous system of primarily earmarked grants to introduce unconditional grants which would ensure greater municipal autonomy in allocation and expenditure of central funds (Annex III / Art 8.3). ▪ It also contains a commitment for the distribution formula for block grants to provide an appropriate measure of equalisation between municipalities with different tax bases.

2) Stabilisation and Association Process and the European Partnership (2003-2008).

Kosovo has been an important part of the Thessalonica Agenda for Western Balkans, initiated at the CoE in 2003, which established a European Partnership to support Stabilisation and Association Process for the participating countries, and contained specific priorities and actions for approximation of Kosovo to the EU. A series of subsequent strategic documents in the following years have reinforced the joint commitment for co-operation on behalf of the EU and Kosovo. In 2005, the EC adopted a Communication “A European Future for Kosovo” (9), and in 2005 the Kosovo Government adopted the First Action Plan for the Implementation of the European Partnership (the following year (2006), an Action Plan for Implementation of the European Partnership was also adopted by the Provisional Institutions of Self-Government, PISG, which started to regularly report to the EU on the implementation process). Finally, in 2008, Based on the Articles 92(4), and 93(4) of the Constitution of the Republic of Kosovo, as well as the Article 4(3) of the Rules of Procedure of the Government of Kosovo No. 01/2007, the Government of the Republic of Kosovo has approved a new European Partnership Action Plan 2008, which reinforced the European aspiration of Kosovo as an independent state. Since that time, revised Action Plans were adopted on an annual basis (10).

The Action Plan for European Partnership sets the following directives concerning decentralisation of social services (10):

- **Local Self Government and Decentralisation among Key Political Priorities (2.1.1.-f)**, including advance the reform of self government and increase administrative capacity to facilitate decentralisation, *taking into account the views and interest of all communities in Kosovo*, adopt the legislative framework and allocate *appropriate budgetary resources*.
- **Specific tasks in decentralisation as Key Short Term Priorities in Public Administration:**
 - Reinforce capacity for government coordination and define more precisely the responsibilities of the central and local authorities for ensuring consistency of policy implementation. Strengthen the efficiency of the government's functions of monitoring the performance of the public service.
 - Improve quality and availability of basic public services to all communities, including a contribution to reduce the demand for services provided by parallel structures.
 - Advance the decentralisation process and adopt inter alia the laws on local government and municipal boundaries.

- Improve public information on access to social security systems and enhance municipal capacities in social assistance matters.

Revised Annual Action Plans for European Partnership during 2008-2010 contained concrete benchmarks for decentralisation of social services outlined below:

2008 Action Plan	<ul style="list-style-type: none"> ▪ Diagnostic analysis of the issues in decentralisation of social services, including observations on importance of social welfare system to Kosovo's Social Policy; the current mismatch between the delivery of social services by the local CSW and their managerial subordination to the MLSW; and the lack of coordination between CSWs and MDHSWs. ▪ Commitment to provide training to social welfare specialists at all levels.
2009 Action Plan	<ul style="list-style-type: none"> ▪ Development of administrative instructions on the transfer of competencies for social services and assistance services from MLSW to municipalities.
2010 Action Plan	<ul style="list-style-type: none"> ▪ Continued transfer of social services and assistance services from MLSW to municipalities; ▪ Adoption of licensing system for Social Workers and NGOs; ▪ Setting up the social services financing system at the local level; ▪ Capacity building for local authorities in management of social and family services provision; ▪ Transfer of competences from MLSW to 4 MDHSWs.

Overview of decentralisation in social services during 2007-2011

Key milestones in the transfer of competences for social services since 2007. Based on the political decisions within the Status process and European Association Process, described above, the Kosovo Government has consistently moved in the direction of transferring the responsibility for social care services to the municipal level from 2007 to present day. This section briefly summarises key milestones in this process.

New Laws developed (2007-2009)	<ul style="list-style-type: none"> ▪ Constitution of Kosovo with a provision on decentralisation ▪ Law on Local Self-Government (11) ▪ Law on Municipal Boundaries ▪ Law on Local Elections ▪ Law on Local Government Finances (first implemented in the Budget 2009) (12)
Action Plan for Implementation of Decentralisation 2008-2010	Description of roles and responsibilities of key stakeholders to be involved in the decentralisation process.
Memoranda of Understanding between Municipalities of Kosovo, the MLSW, MLGA and MEF (February 2009)	Transfer of responsibility for Centres for Social Work (CSWs) to municipal administration and provision of overall responsibility for social and family services to Municipal Departments for Health and Social Welfare (MDHSWs).

Action Plan for Implementation of Decentralisation 2010-2011 (13)	Updates description of duties and the duration of mandate of the Inter-ministerial Group on Decentralization (GND), and foresees establishment of another "Working Group for the Northern municipalities" and formalizes the "Working Group for Public Contact".
IMF negotiations (2010)	Recommendations by the IMF during negotiations over the Stand-By Arrangements for Euro 106 million loan to reduce the amount of specific grants (14).
MTEF 2012-2014	The decision to incorporate funding for Social Services at the municipal level (provisionally in the amount of Euro 1 million) into the General Grant starting from 2012(15).

Since the transfer of responsibility for CSWs to municipalities in 2009, expenditures of these centres in 2009-2011 were covered by a new Specific Social Services Grant. During the first three years after CSWs were transferred to municipal competences, the central government was covering this transfer with a Specific Social Services Grant. Table 1 shows that the size of this Specific Grant has been negligibly small in comparison to other intergovernmental transfers (in 2010, when Social Services grant was the largest in its short history, it represented only 0.6% of all grants).

Table 1. Grants for Own Competencies in 2009-2014

	2009 Actual	2010 Actual*	2011 Actual*	2012 Budget	2013 Projection	2014 Projection
Grants for Own Competencies	207.7	241.2	297.1	298.9	303.6	306.6
General Grant	85.0	99.8	114.2	118.7	123.4	126.4
Specific Health Grant	23.0	30.1	38.2	39.8	39.8	39.8
Specific Education Grant	98.2	109.0	143.4	140.3	140.3	140.3
Specific Social Services Grant	1.5	1.9	1.0	0.0	0.0	0.0
Specific Culture Grant		0.4	0.4	0.0	0.0	0.0
Total Specific Grants as % of All Grants	59%	59%	62%	60%	59%	59%

* Actual for all grants except Social Services and Culture and Sports (including totals) based on MTEF 2012-2014. Actuals for Social Services Grant and Culture Grant - based on MTEF 2011-2013.

Source: MTEFs 2010-2014 (16)(17)(15)

Outline of the current system of intergovernmental finance

This section outlines the key aspects of the current approach to funding decentralised competencies in Kosovo. It distils those elements of the system which are most salient for the analysis and future development of a funding system for social care services.

Recurrent versus capital spending

The system of intergovernmental transfers in Kosovo assumes two distinctly different approaches to recurrent and capital spending. While recurrent spending is covered by a system of central grants, discussed in this section, and designed based on relatively objective criteria, capital expenditures are covered separately and in a much more politicised and much less unified way(18). For example, school construction is funded directly by the Ministry of Education; and capital expenditures of health facilities are funded from municipal discretionary revenues(18). While a transfer system for social services is still shaping, the initial Specific

Social Services Grant of 2009-2011 was supposed to cover wages, goods and utilities of the CSW transferred away from MLSW financing according to 2009 MoUs (19).

Overall approach to intergovernmental finance

The World Bank (WB) Public Expenditure Review (PER) notes that general approach to intergovernmental finance in Kosovo corresponds to wide-spread international practice, and European systems in particular (18). The key aspects of the system are designed to serve the three core objectives, as described below:

1. To provide local governments with access to broad based tax base in the absence of such instrument under municipal control.	Achieved by allocating 10% of central revenues to the General Grant.
2. To ensure some degree of equalisation in discretionary resources.	Achieved by distributing the General Grant largely on the basis of population.
3. To ensure a basic level of funding for key public services.	Achieved by establishing separate earmarked transfers for education and health, and distributing them according to indicators of need.

Importantly, the WB PER also notes that the system of intergovernmental grants in Kosovo is not only equitable and objective, but also establishes rules which are observed in practice. The budgeted amounts of transfers have been consistently allocated to the local governments, and the central government also kept to its legal commitment to increase general grant if actual central revenues exceeded planned amounts by more than 5% in the previous year (18).

General Grant

Coverage. The General Grant system, coupled with local property tax and fees, covers a range of local administrative functions, such general public administration, issuance of documents, etc. and infrastructural functions, such as urban planning and maintenance of small local roads.

The General Grant is designed according to the following principles:

- Its overall amount is fixed at 10% of budgeted revenues of the central government;
- The General Grant is allocated across municipalities in the following proportions:
 - 89% of the Grant distributed on the basis of population;
 - 6% of the Grant distributed on the basis of land area;
 - 5% of the Grant distributed on the basis of minority populations (3% weighted on the size of the minority population, and 2% on whether a majority of their population is composed of national minorities).
- Additional amount (less than 1 Euro per capita) is provided to small municipalities (with population under 140 thousand) (18), and €0 for municipalities with populations equal or greater than 140,000.

Equalisation of fiscal capacity. As discussed earlier, the Ahtisaari Plan contained a commitment to allocate unconditional intergovernmental transfers with a distribution formula which provides an appropriate measure of equalisation between municipalities with different tax bases. Although the fiscal capacity equalisation element of the General Grant is not explicit, it actually represents one of the most equalising approaches to provision of intergovernmental finance. Kosovo legislation divides all revenue sources strictly into own local revenues (which should not be included into the equalisation system) and central revenues (the 10% of which is used for the General Grant). In other words, there are no centrally collected taxes which are

shared with the municipalities and which would imply differences in tax bases across territories which need to be equalised. By pooling all central revenues and allocating 10% of this pool based on, mostly, population criteria, the current General Grant system takes fiscal equalisation for these taxes to the maximum.

The WB PER lists some of the positive aspects of the current design of the General Grant:

- **High degree of equalisation.** Distributing the transfer based mostly on population numbers helps to achieve very high degree of equalisation (according to the WB, disparities in per capita discretionary revenues are smaller in Kosovo than in any other country in the region).
- Minimal macroeconomic risks and their fair distribution between tiers of government. Since the overall amount of the General Grant is fixed as a percentage of central revenues, it does not represent an open-ended commitment, and automatically decreases if central government revenues shrink.

Specific Grants for Health and Education

Specific open-ended grants for Health and Education are earmarked for local spending on these programmes (basic and secondary schools and primary healthcare facilities), and are based on a formula which combines estimates of service costs with estimates of service demand based on numbers of population and school enrolment. In particular:

- **The Education Grant** is allocated by converting the number of students into the numbers of required full time teachers (by teacher ratio norms for various types of schools) and then converting this number into a cost estimate based on current salary level(18).
- **The Health Grant** is allocated by converting the number of population into the number of annual visits to health facilities (2.8 visits per capita), and then converting this number into a cost estimate based on the assessed cost of each visit (Euro 3.90)(18).

The more rigid design of the two major specific grants implies more risks from this system for both levels of government, compared to the General Grant. On the one hand, it represents a potential macroeconomic risk for the central government (since the amounts of the Grants are not fixed as a percentage of central revenues, they represent an open-ended commitment, which would increase if some of the formula variables - such as enrolment figures, population numbers, or cost of services, increase). On the other hand, while local governments are responsible for provision of these services, they face the risk of discretionary decisions by the central government regarding the sizes of the specific grants and are dependent on the willingness of the central budget to compensate for any changes in the formula variables (especially service costs such as wages).

Specific Social Services Grant

None of the legislation developed so far to guide the transfer of competencies to municipalities contains clear directions about the formula which should be used for allocation of resources to fund these transferred expenditures. Social Services represent only one function for which such decision yet has to be made (other public services such as Cultural Affairs or Forestry Protection are also subject to the need to devise a proper formula solution).

During 2009-2011, the Government of Kosovo applied temporary practical rule for allocation of the Specific Social Services Grant, which divided its amounts based on the historical amounts of spending on this programme by the MLSW (that is , for 2008)(18)(19).

This transitional approach essentially implied continuation of funding for CSW from the central budget based on the historical pattern of spending, and was therefore inappropriate to facilitate the core goals of the decentralisation agenda, which assumed a shift of financial, administrative and managerial power down to the municipal level.

Macro-fiscal risks and factors

Kosovo is entering a period of testing times to its capacity to back political ambitions with strategic, disciplined and accountable public financial management. The recent reviews of public finance in Kosovo (the 2010 Public Expenditure Review by the World Bank(18) and the 2011 Concluding Statement of the 2011 Article IV Consultation Mission of the IMF(20)) have demonstrated that after almost a decade of conservative fiscal policies, the Government is considering a more expansionary approach, which is perceived by international observers as unsustainable and risky. The IMF Stand-By Programme was interrupted in 2011 as a result of provisions in the 2011 Budget which deviated from earlier commitments, in particular regarding the planned increases in the wage bill. Latest analysis by the WB and the IMF recommend restrictions on the expenditure side and a reinforced effort to improve efficiency in public service provision, which would entail new approaches to their design, management, administration and audit.

The emerging system of intergovernmental fiscal relations is a particular macro-fiscal concern. As partially discussed above, the design of the system could entail certain macroeconomic risks. This includes:

- open-ended commitments within Specific Grants distributed with formula based on absolute service costs;
- a potential tendency for specific grants to crowd out financing of own competencies from General Grant and own revenues (as it was intended by the Ahtisaari Plan and the LLGF);
- the possibility that the current design of the General Grant - which is highly equalising and does not incorporate incentives for higher local fiscal efforts – would discourage local taxation.

The recent trends in Kosovo fiscal performance have highlighted the possibility of the risks outlined above.

Concerns over open-ended commitments in the specific grants

- The WB PER notes that the Government has recently demonstrated “considerable eagerness to increase wages in education and health”, which is a policy with unavoidable implications to the Specific Education Grant. The choice of whether the wage increases will be reflected in the transfers will imply either increased expenditure burden on the central budget, or an unfunded mandate for the municipal authorities(18).

Concerns over the size and share of specific grants

- Furthermore, overall amount of specific grants has palpably increased in the recent years (from 59% of all grants in 2009 to 62% of all grants in 2011). As already mentioned, international observers note that according to the LLGG, own municipal functions should be financed from the general grant or own source revenues, and that in the future additional specific grants should be phased out(18)(6)(2).

Concerns over insignificant local tax effort

- On the other hand, with reference to the IMF, the WB notes in the Public Expenditure Review that the rapid increase in revenues available to the municipalities through the General Grant in 2008-2009, in reflecting to the rapid increase in central revenues after the Declaration of Independence, was followed by a reduction in own revenues in 2009. IMF believes that this decrease in own revenues may have implied reduced local tax effort in response to a sharp increase of central transfers (coinciding also with local elections)(14)(18).

- Overall dependence of local authorities on central transfers and low level of local taxes resonates with larger concerns over the insufficient role of direct taxes in the Kosovo's budget and the unsustainable tendency of the Government to rely on one-off revenues such as donor aid or sales of assets. Recent consultation between the Government and the IMF discussed particular plans to strengthen direct taxation system, including the system of local revenues (such as the plans to gradually increase the rates of the property tax(14)).

Incorporation of these macro-fiscal concerns into the design of the Kosovo system of intergovernmental finance will be a critical condition for its long-term fiscal and political sustainability.

Analytical Framework for the Social Services Transfer Formula

Economic argument for decentralisation of social services in Kosovo

Why countries chose to decentralise social care?

Social care services as a sector in public policy is highly sensitive to individual needs of its clients, which could be very diverse. In particular, this sensitivity is reflected in the need to choose the menu of services available to the people at risk most effectively. And although some basic principles of the needs of various categories of vulnerable population could be visible at central level, it is very difficult to make a decision at the central level on the precise choice of such service menu, which would take into account individual needs of people living in various regions and various communities.

Social care services for vulnerable population groups is an appropriate case for applying the principle of subsidiarity, and is accepted by intergovernmental finance systems in almost all European countries. According to this principle, public functions should be decentralised to a the lowest level of government which would be still capable to effectively administer these functions.

The subsidiarity principle becomes especially important for social care services when governments intend to diversify the menu of available standard services – typically, residential services for children, elderly or disabled – in order to support a wider and more complex range of vulnerabilities (to provide services which would be more individualised and respective of individual needs of clients compared to wide-scale residential institutions). The primary idea of such reforms is always to incorporate individual needs of every person. Therefore, any diversified menu of services is more likely to achieve intended and objective benefits when it is administered and funded by a level of government which is closest to the client – therefore, when this function is, to the maximum extent possible, decentralised.

Certainly, subsidiarity should also match the need for the financing authority to be flexible in incorporating the local context of the client with the capacity of this authority to effectively provide respective services. In particular, this level of government should have sufficient capacity to develop local policies for delivery of social care on its territory, to analyse the needs of the vulnerable people and to represent their interest, to engage in commissioning services, and in the administration of tendering procedures etc. Very often, local (or any sub-national) authorities lack such capacities, especially in transition countries. However, engaging in long-term strategic reforms in this sector requires policy makers to understand clearly, which of the levels of government should be responsible for provision of such services (at least in the long term perspective), and incorporate steps for gradual decentralisation into the reform agenda(21).

Caution: what do policy makers mean by decentralisation?

Decentralisation is a vague term which could mean different things. In terms of decentralisation of public functions, a principal difference revolves on the question of which aspects of service provision (or which public powers) should be decentralised: financing, administering, regulation and inspection, or any combination of these. When these dimensions are addressed as part of the system, the response to this question, in effect, defines the degree of decentralisation.

Traditionally, the degree of decentralisation is ranked by subdefining it into three sub-types.

- The most **advanced** form of decentralisation – *devolution* – is when all decisions on the implementation of the corresponding function are made locally (that is, all three powers – financial, administrative and regulatory are transferred to the lower level).
- The **moderate** form of decentralisation – *delegation* – is when the local level is empowered to make decisions which are to some degree controlled by the centre (in other words, the lower level receives full administrative and shares financial and regulatory responsibility with the center).
- The **weakest** form of decentralisation – *deconcentration* – is when local level only implements certain tasks of the central government (in this case, the local level receives only administrative powers, but full financial and regulatory responsibility remains at the centre).

Many emerging European countries experience considerable difficulties in clearly choosing an optimal type of decentralisation for social functions, and for social care policy in particular. Choosing the type and degree of decentralisation of public services usually entails difficult political decisions regarding what constitutes responsibilities and powers in service provision. While dividing responsibilities for administering expenditures can be relatively easy, deciding on who should be responsible for the policy-making of the service provision (including regulation, standard-setting and quality control) is typically more challenging and time-consuming(8).

This uncertainty and confusion brings serious conflicts into their systems of intergovernmental fiscal relations, making it essentially impossible to build an effective system of services for the vulnerable population groups. Decentralisation is a tool which is both powerful and risky. Any degree of decentralisation results in some vertical and horizontal imbalances in allocation of powers and resources (discussed in detail in the next section (on page 18)). Therefore, to effectively administer social services through a multi-layered form of governance requires a well-designed system of intergovernmental transfers, which work as safeguards against the side-effects of decentralised service provision. A clear choice of the decentralisation model (out of the three types listed above) has direct implication for the choice of the system of transfers needed to support the decentralised service provision. If decentralisation model is not defined clearly, it becomes more difficult to select an appropriate transfer system, and the side effects of decentralisation can persist and destabilise the entire system of service provision, which has happened in some of the transition countries across Europe(21).

Conceptual meaning of legal decentralisation definitions in Kosovo

Legislative frameworks operating in Kosovo (defined in the LLSG and the LLGF) rely on a terminological distinction between types of competencies / expenditure mandates, which has apparent similarity with the traditional classification presented above, but implies a different conceptual meaning. To avoid any misunderstandings, these terminological differences are outlined below.

In line with the directions set by the Ahtisaari Plan, the LLSG and the LLGF define the following framework for decentralisation of responsibilities in Kosovo (in the part which concerns social service provision):

“Own Municipal Competencies”	“Delegated Competencies”	“Enhanced Competencies”
Definition in the LLSG:		
Municipalities shall have full and exclusive powers, insofar as they concern the local interest, while respecting the	Central authorities in Republic of Kosova shall delegate responsibility over the following competencies to	Certain municipalities explained below shall have their own competencies enhanced in the areas of

standards set forth in the applicable legislation.	municipalities, in accordance with the law. Delegated competencies must in all cases be accompanied by the necessary funding in compliance with objectives, standards and requests determined by the Government of Kosova.	health, education and cultural affairs and shall have participatory right in selecting local station police commanders as set forth in the subsequent articles. Central authorities of Republic of Kosova shall monitor the exercise of enhanced competencies, in accordance with the central legislation providing for equal access to public services; minimum quality and quantity standards in the provision of public services; minimum qualifications of personnel and training facilities; general principles on licensing and accreditation of public service providers.
Competencies related to social service provision:		
i) promotion and protection of human rights; k) provision of family and other social welfare services, such as care for the vulnerable, foster care, child care, elderly care, including registration and licensing of these care centres, recruitment, payment of salaries and training of social welfare professionals.	No competencies explicitly linked to social service provision. However, delegated competencies include - “Distribution of social assistance payments (excluding pensions)”, which is a programme with linkages to social vulnerabilities through wider social protection and income support system.	No explicit link to social service provision.
Equivalent in terms of traditional scale of degrees of decentralisation:		
Considerable delegation of authority	Deconcentration of authority: local policy-making discretion is minimum; local function is limited to administration of centrally defined programmes which are fully reimbursed from the central budget.	Limited delegation of authority. Some policy-making functions are decentralised to the sub-national level, but should be exercised in accordance with national standards.

Conceptual meaning of actual decentralisation practices in Kosovo

While strategic and programmatic documents such as Ahtisaari Plan, the LLSG, and the LLGF outline the long-term vision for a decentralisation model in Kosovo, the current practice as of 2011 – while the decentralisation reform is still in progress – still divides expenditure mandates in a transitional, partially decentralised way.

The table below (based on(3)) summarises the features of the current approach to sharing responsibilities for the provision of social services in part which is supposed to be fully decentralised in the future, namely:

- promotion and protection of human rights; and
- provision of family and other social welfare services, such as care for the vulnerable, foster care, child care, elderly care, including registration and licensing of individual and organisational service providers, recruitment, payment of salaries and training of social welfare professionals.

	Financing	Administration	Regulation / Policy-making
Units for Social Work within the CSWs	Decentralised to municipal level, but without clarity about coverage and rules for allocation of these resources.	Decentralised to municipal level (part of municipal administration, with salaries supposed to be covered from the municipal budget)	Centralised within the MLSW, although in theory municipalities acquired full responsibility for this function based on the 2009 MoUs.
MDHSWs	Decentralised	Decentralised	Decentralised
Residential services for children, elderly and disabled	Fully centralised	Fully centralised	Fully centralised
Payments for Foster Care	Fully centralised	Fully centralised	Fully centralised
Payments to NGOs providing services at municipal level	Fully centralised	Fully centralised	Fully centralised

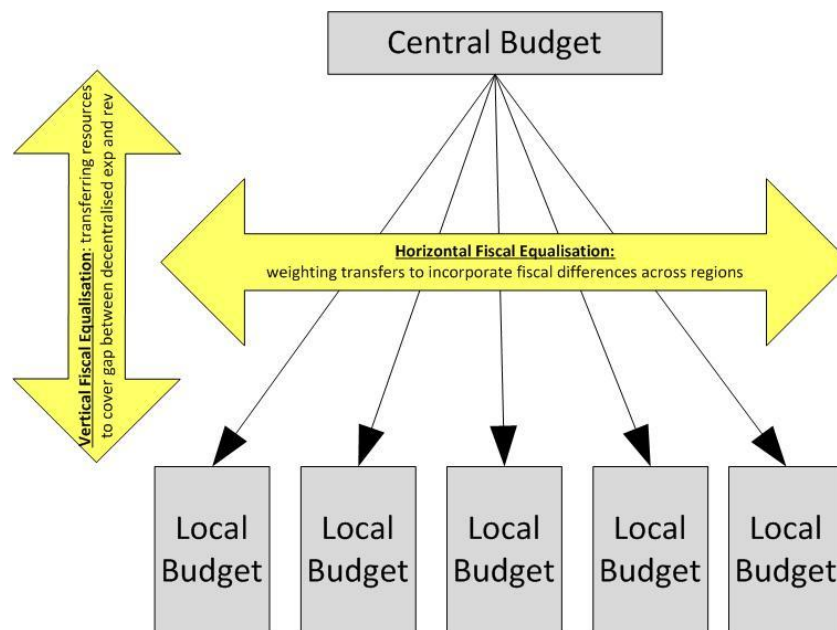
Designing transfers to match selected decentralisation patterns

Horizontal and vertical imbalances as side effects of decentralisation

Decentralisation as a method of service provision in multi-layer governance systems, always gives rise to two kinds of imbalances - horizontal and vertical. As previously noted, decentralising responsibilities down to sub-national tiers of governance may, on the one hand, create a gap between new spending demands and existing revenue capacities at the local level (creating a “vertical imbalance”). And, on the other hand, decentralising responsibilities down to sub-national tiers of governance may highlight the differences between communities of the same administrative level in terms of their fiscal potential and therefore their ability to cope with the transferred spending responsibilities (creating a “horizontal imbalance”).

Fiscal imbalances resulting from decentralisation require some corrective response: in the form of horizontal and vertical fiscal equalisation. To address fiscal imbalances in the multi-layer service provision system, the central governments use systems of transfers and revenue sharing, to fill the resulting gaps. These transfer systems are designed on the basis of: (a) the nature of the fiscal imbalances (which depend on the selected decentralisation pattern) and (b) the society’s choice over the degree of desired equalisation (which does not have to be complete and may leave some politically chosen degree of imbalance).

Figure 1. The Logic of Vertical and Horizontal Fiscal Equalisation



The emerging system of fiscal transfers in Kosovo will have to manage the risks inherent in decentralisation. To support the construction of a safe and efficient system of transfers to fund decentralised provision of social services, further sections describe the essence of the different types of imbalances and the nature of transfer systems which could help to correct them. As discussed earlier, an appropriate transfer system is critical for the political sustainability of decentralisation reforms, since it should serve as a safeguard against the fiscal and social stress created by the transfer of responsibilities. Experience of other countries in the region illustrates that failure to mitigate systemic stress may destabilise systems of service provision and create macro-fiscal risks(8)(21).

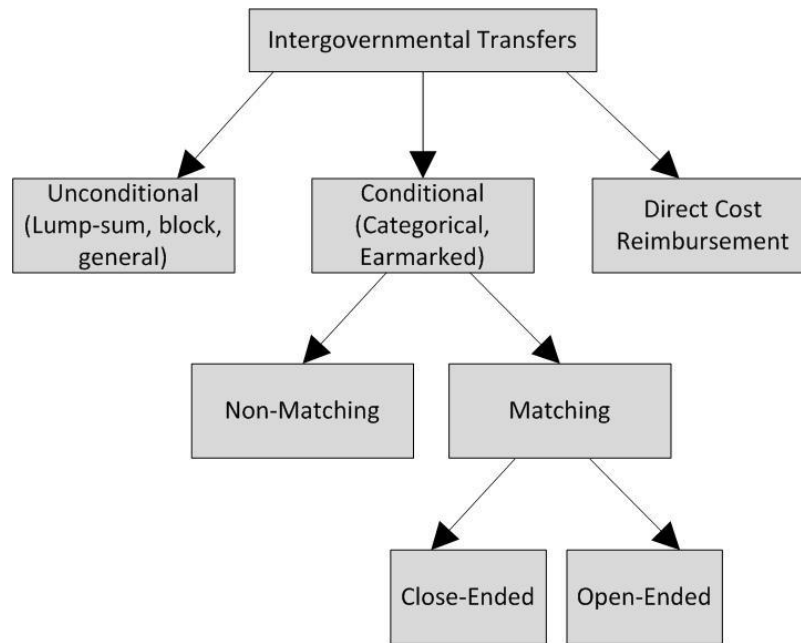
Vertical fiscal equalisation

Vertical fiscal equalisation is required to correct the gap which may be created between the **expenditure mandate** decentralised to sub-national governments and the **revenues available to them** for funding these expenditures.

The kind of transfers needed to correct vertical fiscal gap is dictated by the type of decentralisation of expenditures which influences the nature of the expenditure mandate(22):

- **Significant autonomy; no strings attached to grant.** If the expenditure mandate assumes that local governments are given substantial policy-making discretion in service provision, the central government may cover the vertical fiscal gap with an unconditional (block or lump-sum) grant. This approach corresponds to the classical “devolution” or “delegation” of powers.
- **Less autonomy; conditions and matching requirements attached to grants.** If the central government decentralises only partial decision-making freedom to the local level (e.g. administrative responsibility), it usually provides respective funding based on certain conditions, which reflect policy and regulatory decisions regarding these services made at the central level.
- **Restricted discretion at local level: direct reimbursement of costs.** If local governments have no discretion about the level and amount of expenditures, which are fully regulated by central authorities and are only administered by local officials, the central government usually takes full financial responsibility for such expenditures, by directly reimbursing all costs.

Figure 2. Types of Intergovernmental Fiscal Transfers



The fact that vertical fiscal equalisation depends so much on the nature of the chosen decentralisation pattern (and the essence of the decentralised expenditure mandate) often makes it the most problematic aspect of the transfer design and is a frequently source of multiple confusion. The chosen transfer system should correspond as precisely as possible to the level of actual decision-making autonomy delegated to the sub-national authorities. If the transfer system assumes higher policy discretion than is actually available to local governments, it may create a mismatch between the funds available and the amount of services required by central legislation, and therefore represents an unfunded mandate. Capturing the appropriate amount of local discretion within the choice of transfer system is a complex task that requires qualitative and functional analysis of the decentralised policy frameworks (such as who should undertake regulatory functions linked monitoring, inspection and quality control), rather than exact technical calculations. At the same time, the political consequences of unfunded mandates can be extremely detrimental.

Horizontal fiscal equalisation

Horizontal fiscal equalisation is required to weight the amounts of intergovernmental transfers allocated across individual local budgets to reflect the differences in their ability to provide services resulting from the differences in fiscal capacities and/or objective variation in the costs of service provision.

The elements of the transfer system which help to address horizontal imbalances include various approaches to incorporate some measures of relative fiscal capacity, fiscal need and fiscal effort across communities, and various ways to equalise them.

- **Sharing of central revenues and equalisation of fiscal capacity.** If the central government shares some of the central taxes with the local communities from which they originate, it may want to incorporate the difference in the bases of these taxes across territories into the transfer formula to fund delegated spending. In this case, the gap to be covered by the formula for each local budget is calculated as a difference between the estimated cost of decentralised expenditure mandate and the revenue potential from the delegated central taxes. This approach is least equalising since it leaves local authorities an opportunity to exert local effort over central tax collection, and to keep the revenues they collect above estimated potential, or remain with lower transfers if they fail to raise up to their estimated potential. This approach is not suited to Kosovo given the current approach to municipal finance.

- **Sharing of central revenues and equalisation of actual collections (Gap Filling)(6).** A more equalising approach is to fill the gap between fiscal needs and actual revenue collections. This approach can lead to more even distribution of resources, but it also contains a disincentive for local governments to increase effort to collect central taxes, since any loss of these revenues would be compensated by the central budget.
- **Complete equalisation based on fiscal needs: no sharing and no equalisation of central revenues.** The central government may chose to not share any central taxes with local budgets. In this case, equalising the territorial variation of central tax bases will not be required, and the transfer formula will be limited to estimation of fiscal needs. Such approach may lead to considerable horizontal equalisation, since all central revenues would be accumulated in the central budget and redistributed based entirely based on assessed fiscal needs.

Importantly, this latter approach is the one which is currently applied by Kosovo for the allocation of its General Grant. Existing taxes are clearly divided between tiers of budgets into own revenue sources (such as property tax) and central taxes which are not shared with local governments. As a result, there is no need for the formula to account for the differences in the tax bases of any central taxes. Instead, the pool of central revenues designated for redistribution across municipalities is allocated only based on assessed differences in their relative fiscal needs (mostly based on population numbers).
- **Equalisation of own revenue potential (undesirable).** It is highly undesirable and counterproductive to consider inclusion into the equalisation formula of the own revenues assigned to local governments. If the local governments can influence the rates of taxes, it is critical to ensure that their decisions to raise local rates or to build up own revenue bases would not be penalised by the reduction of equalisation transfers.

Risks and misunderstandings of policy-based budgeting in the multi-tier governance systems

This section reinforces the key message from the previous section about the dangers of miscalculations in the systems for compensation of horizontal and especially vertical imbalances, and highlights some of the specific problems that could result, as well as recommendations on how to avoid (such as transitional rules).

The problem of unfunded mandates and the risk of mismatch between fiscal and administrative decentralisation

The strength of the political factor typically influenced the sequence of decentralisation reforms in post-planned economies. Many post-planned economies have pursued decentralisation reforms based on political agenda of democratisation, accountability and restoration of inefficiencies resulting from overcentralised service provision.

Decentralisation of regulatory function proves to be more difficult that decentralisation of finance, resulting in dangers of mismatches. Many transition countries have aimed to design their decentralised systems in accordance with the principles of the European Charter of Local Self-Government and its major guideline about the need for the central government to support any transfer of expenditure mandates to sub-national levels with adequate financial resources. However, experience has shown that the decentralisation of financing is often a more straightforward process than decentralisation of policy-making and regulatory functions. As a result, even when spending functions have been formally assigned to lower levels of government and supported with transfer systems based on assumption of significant fiscal autonomy (i.e. block grants), in reality local governments have often remained subject to rigid

vertical regulation of their spending choices, and therefore subject to unfunded central mandates.

A typical example of a mismatch is funding deconcentrated expenditures with an unconditional block grant based on relative rather than absolute expenditure needs. For example, a mismatch between fiscal and political decentralisation arises when some expenditures are funded through a general (block) grant which is based on estimates of relative, rather than absolute expenditure needs (based on objective variables such as population), while local governments are actually subject to either (a) exact input-based expenditure norms in spending this budget, or (b) precise managerial instructions which dictate how the funds should be allocated (e.g. prohibition to fire staff coupled with wage minimums, numbers of required facilities and units, sector-based input norms such as teacher-per-student ratios etc). Under such conditions situation, the idea of the transfer allocation approach is to use the transfer mechanism to equalise *opportunities* between regions, leaving sufficient flexibility to the local authorities to take these opportunities forward. At the same time, parallel input-based norms and regulations imposed by the central ministries reflect a conflicting alternative approach, which implies that decisions on how to use opportunities are made at the central level and are communicated to the local authorities as fixed managerial instructions. In other words, the regulatory function in this example is only deconcentrated, while financing is delegated or devolved, which creates a dangerous mismatch

Uncertainty as a potential time bomb, creating impetus for retrograde change

Decentralisation is a complex reform process which never happens overnight or by simply creating a budget formula. Therefore it is typical for some concepts to remain undefined and subject for further clarification. However, uncertainty about political definition of decentralised responsibilities coupled with mismatching patterns in financial and regulatory decentralisation can become an area of policy that is open to multiple interpretations and can therefore become vulnerable to manipulation by various interest groups. A mismatch between delegated finance and deconcentrated policies creates fiscal stress at all levels of government, and often prompts the need for risk coping strategies:

- Central government can become stressed by the disproportionate increase of responsibility for accurate calculation of transfers, which results when expenditures are shifted to the block grant financing but without regulatory release.
- Local governments can become stressed by their inability to fund pre-defined services in pre-defined institutions with transfer funds which are, by definition, insufficient (since they are provided based on relative, rather than absolute needs).

It is often the case that under such stressful conditions, policy makers across all tiers of government revert to coping strategies which lead to the reinstallation of familiar pre-reform practices, rather than focusing on measures that promote further decentralisation. Institutional inertia can prompt local and central officials to manipulate with the uncertainties in the system and establish pre-reform budgeting approaches (e.g. allocation of transfers based on absolute needs based on national norms and standards, even where public functions are supposed to be delegated to sub-national levels).

Misunderstandings regarding the role of unit cost data in sharing responsibilities for social care services

A frequent point of discussion for the design of transfer systems for decentralised service provision is focusses on ways to assess and apply unit costs to service delivery. The need in unit cost assessment is often referred to in connection with the following challenges: introducing social service commissioning and contracting, diversifying the network of social service providers, increasing the role of alternative and community-based services, and improving budgeting techniques at all levels. But the most controversial questions with regard to

social service unit costs pertains to their role/utility for assessing the size/amount costs in defining the size of intergovernmental transfers: what should the role be and what indicators should be used at this early stage of the decentralization process?

The main purpose of unit cost indicators is to inform decision making in social policy, and therefore appropriate use of costing depends on the role played by the given tier of government in service provision. Information about how much it costs to provide a certain type of social service can play a deciding role at various stages of decision-making by officials of all levels of government. However, it is clear that stakeholders should make the whole range of various decisions in the process of policy design and implementation. When the central government provides resources for decentralised provision of services to sub-national budgets, the way it should use costings of services depends on the nature of the decentralisation “agreement” between the tiers of government (23).

- **Weak local autonomy requires transfer design to include more precise costing of services.** The weaker the degree of autonomy granted to the local level, the stronger the role of the central government resembles direct service procurement, and the more it should rely on exact estimation of absolute costs of services, which it should reimburse directly or through earmarked transfers.
- **Stronger local autonomy shifts the role of unit cost estimates from an absolute assessment within the formula towards strategic sampled analysis for policy development purposes.** When a country opts for a model which gives more autonomy to local government (e.g. when delegating takes place), the role of the central government is different.

The central level typically retains control over certain aspects of services delivery (i.e. their quality and accessibility). However, the central government performs these functions not through direct influence over the range of services procured, or over the selection of service providers. Rather, it exerts influence through a system of reasonable, realistic and controlled effectiveness standards of service delivery to ensure that its requirements are met. The central government also remains responsible for assessing social expectations regarding guaranteed rights for social services, and for assessing covariate social risks that transcend particular municipalities.

Thus, the principle responsibilities of central government is for macroeconomic decisions about the optimal size of public sector social services and the need to augment it or redistribute functions among tiers of government or to particular specialised agencies.

Although many factors often need to be taken into consideration for making decisions of this nature, they should necessarily include objective calculations as to how realistic are the declared civil rights, or how prevalent particular risks might be, or whether the risks are amendable to particular types/models of cost-effective intervention.

Such calculations should incorporate information on unit costs of service provision. However, approaches to the use of such indicators in strategic decisions for social policy design should be differentiated from approaches that use them for direct procurement of services. In strategic planning at policy level, data should be collected based on representative samples; analysis should be performed in cases where it has to inform specific strategic tasks (not as a routine procedure) and should not be related to the tactical decisions about allocation of funds to specific budgets and providers (23).

Additional obstacles to decentralisation of social care services at the level of institutions / service commissioning

Decentralisation of public functions is only one step towards making the provision of the services more efficient. The key potential benefit from appropriate decentralisation is that it opens opportunities for efficient policy-based budgeting: that is, for authorities to allocate funds flexibly based on their analysis of the local public value trade-offs. Setting spending goals should be combined with constant analysis of what is best for the people confronted with social vulnerabilities and risks that are responsive to social service interventions. A policy-maker may have certain strategic goals (e.g., in the case of services for children without parental care, a strategic goal can be to make sure that, all other things equal, children have an opportunity to access care which is closer to a family setting – such as foster care or guardianship), However, no policy maker can every know what is the concrete mix of needs of children in every community, what is the share of children requiring specific professional or medical assistance, specific legal support etc. Such specific needs and levels of dependency on additional social support vary across population, across various categories of vulnerable population groups, across communities, regions, countries, and cultures(21)(23).

Efficient decentralised policy-budgeting requires additional tools such as service commissioning, and allocation of resources based on the “Balance of Service Provision”. Additional tools which could and should be applied to satisfy these choices in a decentralised budgeting system include various forms of service commissioning, (when a state purchaser represents the interests of the child, assess the child’s needs and commissions appropriate services on a competitive basis – such as through an NGO or other type of service provider) and the “Balance of Service Provision” model (described in Box), when a policy-maker at any given tier of government allocates its resource envelope across a balanced menu of services, depending on a composition of needs among the children in respective community, and on marginal costs and benefits of these services. This approach applies equally to service decisions pertaining to other groups in need of social services (e.g., the elderly, people with disabilities, victims of domestic violence etc)

All of these tools are difficult, probably impossible, to implement if responsibilities for policy-making in social service provision are fragmented across tiers of government, and when the authority in charge of social service policy is not in charge of a flexible amount of resources which could be moved between types of services, depending on the needs of the clients.

Box. “Balance of Service Provision” Model (example for Child Care) (24)

A balance of service provision is a menu of alternative forms of care for every vulnerable categories of children. The financing agency defines the share of every form of care based on specific analysis of the current needs of children matched to the comparative costs of needed forms of care to the budget.

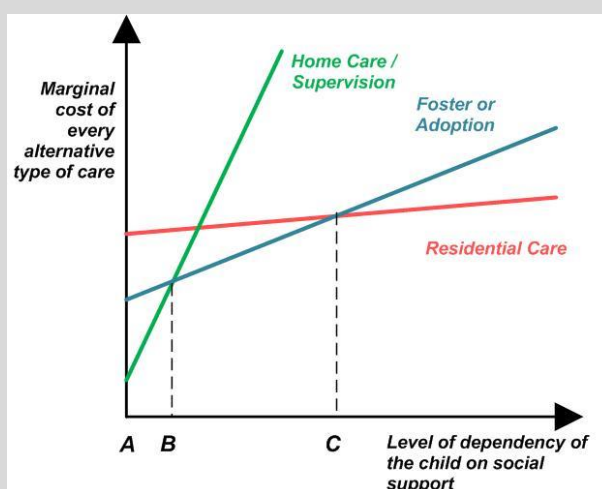
Obviously, for any kind of vulnerability – including absence of parental care – children greatly differ in terms of the level of their dependency on the need for social care. Although the benefits of growing up in a family are well known, some of the children, for example, might require more professional or additional care (e.g. medical assistance related to certain health-related problems), which could be more conveniently or effectively provided in a residential setting.

On the other hand, there could be a whole range of alternative forms of care with varying depth of proposed support, including elements of residential support. Respectively, services differ in their cost. The task of the government as purchaser is to define which groups of vulnerable children it has to support, and to find for each of these groups a form of care which represents the best combination of a needed amount of services and their cost.

This box explains the principle of such analysis and calculations, for an example of social services for children without parental care.

- Horizontal axis measures the level of dependency of a child (or group of children) on additional help: this dependency can be measured in various units reflecting the amount of additional help needed (from periodic consultations to continuous professional or medical support).
- Vertical axis measures marginal unit costs of each form of services: how much does it cost to the budget to provide needed level of support using this particular form of care? For example, providing additional medical help to a child with a disability is more expensive when provided at home compared to the same level of medical support in a residential home or specialised boarding school.
- After defining these indicators, the agency which defines the policy and financing decisions for the given category of vulnerable children on a given territory can select, for any of sub-categories of such children, a type of care which would bring those children biggest benefits at the lowest cost (for each value of X this means selecting a service represented by the lowest curve). For example, for children who need support at the level in the interval AB (quite low) it is preferable to provide services at home, etc. Further on, depending on the composition of sub-groups, the policy-maker can identify and finance an optimal overall balance of service provision.

Figure 3. An example of defining optimal forms of services for children



Preliminary Discussion of Options

Strategic objectives

The need to address long-term vision for decentralisation of social services in Kosovo

The philosophy of the future transfer system for social services has to incorporate the political vision for their decentralised provision, described in the earlier sections, including the following key parameters:

- Provision of the integrated function of social services as own municipal competence (that is, such which ensures sufficient policy discretion and financial flexibility);
- The need for any block grant financing to take into account, inter alia, the physical size of the municipality, the number of inhabitants including the number of members of the Communities that are not majority in the municipality, and the relative access of the inhabitants to public services.

The need for transitional rules to address temporary mismatches

While the formula needs to focus on a strategic vision, it also has to take into account the specific requirements of a transition period during which the country's decentralisation system will be taking shape (including proper transfer of functions; setting up quality control mechanisms, building capacities etc). These transitional challenges, which need to be addressed by the formula, are listed below:

- The need to avoid financing shocks across individual budgets. Any change in approach towards intergovernmental transfer allocations may result in significant financial implications for individual budgets, including budget cuts. Most typically, when central government starts allocating finances based on more objective indicators of demand (as opposed to historical trends and existing infrastructure), this can often lead to the reallocation of resources from more infrastructure-endowed communities towards less-endowed communities. While this may be less palpable at the stage of decentralisation of CSWs, the issue is likely to become much more urgent if/when more substantial infrastructure such as residential service providers are also allocated to local administrations. Abrupt financial changes are not desirable for a number of reasons:
 - On the one hand, significant financial losses in the Municipalities with more developed service delivery networks and infrastructure may lead to reduced scope and quality of service provision for their inhabitants.
 - Moreover, under the system of manual allocation of funds through centralised management by the national government, infrastructure for service provision tends to become concentrated in territorial units with more pro-active administrations. Abrupt introduction of new approaches with risks of financial cuts for such Municipalities may represent penalisation of the most effective administrations and discourage their pro-active approach to budgeting and service-management for the future.
 - On the other hand, previously under-endowed Municipalities may have relatively less developed capacities for effective management of funds and service provisions, and may not fully and immediately benefit from windfall budget increases. These additional funds may be simply re-allocated to other functions or used in ineffective or inefficient ways based on pre-reform practices.
- The need to incorporate transitional uncertainties in the decentralisation patterns. As discussed in detail in earlier sections of this paper, decentralisation never happens overnight, and in the process of transferring some competencies, others may have to remain deconcentrated for a number of years until local governments acquire appropriate capacities for comprehensive policy management of integrated social service functions. Although social services should be funded by the General Grant in the long term (according to the political commitment), rapid transfer of this function into unconditional financing based on relative fiscal needs such as population may create a period of functional mismatch and excessive fiscal stress on all levels of government, with long-term risks of retrograde backlash in reforms. To avoid this type of risk, central government will need to explicitly address the expected transition period within the formula design, ensuring that local governments receive sufficient funding for the precise expenditure mandates imposed by the central authorities as long as such mandates will remain centralised.
- The need to avoid temporary dry-spells. One risk of institutional uncertainty is a tendency to either jeopardise macro-fiscal constraints by uncoordinated increases of open-ended commitments (such as specific grants based on estimates of absolute needs) or to subordinate emerging transfer components to the needs of fiscal discipline in the absence of a reliable alternative solution. Such risks hold a high degree of realism for social services in Kosovo, if their funding is to be incorporated into the General Grant in 2012 without proper compensation for the lack of local capacity and managerial authority to protect and effectively spend these funds, or without compromising the scope and quality of services provided.

How to combine transition rules with long-term vision?

The generally accepted logic for addressing these risks is to apply clear transitional rules – e.g. transitional coefficients in the formula – which would help to simultaneously achieve the following:

- To clearly and transparently reflect the new, strategic approach in the formula (e.g. the new indicators of demand such as population numbers rather than existing infrastructure). The transitional indicators should be a subordinate part of the formula, so that the overall logic reflects the reformed approach, rather than the transitional approach, and therefore manifests reform commitment on behalf of the central government and prompts all actors to treat the transition period as both a hard time constraint and a hard budget constraint.
- To set a realistic transition period, covering a number of years (e.g. 5, 7, 10 years), and assume gradual but determined phase out of the transitional elements in the formula, which would again support the philosophy of strong commitment of all actors to the strategic vision of decentralisation for social services. Transitional rules (e.g. coefficients) should be selected with the help of statistical calculations based on a selected base year, but should be firmly fixed for the rest of the transition period.

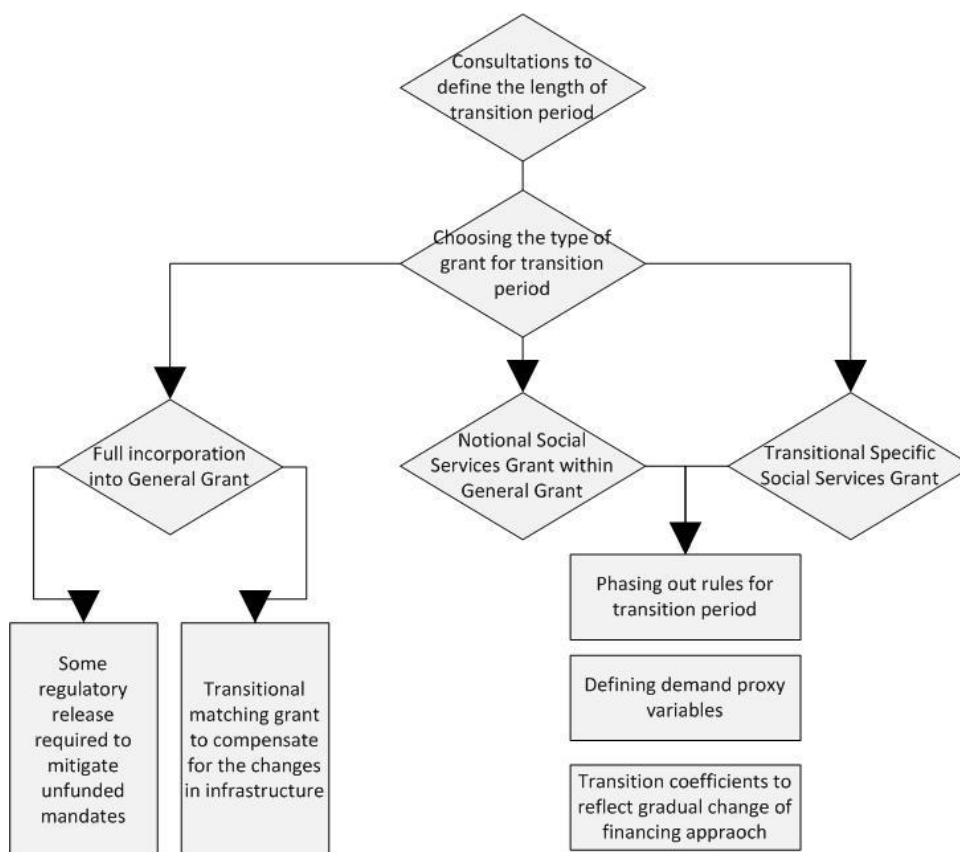
Outline of tentative options for development of the formula

This section outlines the general proposed algorithm for the development of the transfer formula for social service provision, and lists some of the statistical simulations and economic assessments which would support each of the stages.

As illustrated in Figure 4, the design process will have to consider, inter alia, the following aspects of the formula, making respective choices based on consultations and data analysis:

- **The length and nature of the transition period.** As was discussed in earlier sections, a substantial transition period is likely to be needed for gradual transfer of a broader scope of responsibilities for social services to municipal level, including wider range of functions (such as responsibility for support to foster care or services provided by the NGOs) and including stronger managerial and regulatory functions. The length of this period will depend on the time it will take for the local authorities to develop appropriate skills and capacities, including the critical capacity for policy coordination and dialogue. As was mentioned earlier, most observers agree that the process of building full-scale complex decentralised structures in Kosovo require significant institutional changes and strengthening, and is likely to take significant time (6). While exact estimation of the needed transition period is, of course, impossible, it would be beneficial to agree over some specific amount of time, which would be clearly communicated to all actors and which would be maintained as a hard time constraint symbolising commitment and determination of all parties to gradually move towards the long-term political vision of decentralised service provision, reflected in the country's key strategic documents and frameworks such as Ahtisaari Plan.

Figure 4. Tentative algorithm for development of the transfer formula for social service provision



- **The choice of the type of transfer for the transition period.** As already discussed, financing of social services in the long-term should become a part of the General Grant. However, the question may be open about some temporary arrangement for the transition period. The three possible options are:
 - full incorporation of the social services in the General Grant (as it is currently intended by the Budget Circulars and MTEF 2012-2014(15));
 - incorporation of social services into General Grant in a form of a notional sub-component specifically designated and calculated for social services but not earmarked for these purposes;
 - continuation of a specific social services grant for a defined transition period, but gradual change of rules for its allocation (moving to more objective and relative indicators of demand) and gradual phasing out towards lump-sum financing.

- **Development of proxy variables to reflect relative demand for social services.** The key strategic task for the future formula is to identify objective variables which would reflect the differences across Municipalities in their relative expenditure needs for social service funding(25). Ideally, this should be achieved through the following steps:
 1. ***With the help of existing or specifically commissioned additional sociological survey (e.g. HES), undertake factor analysis*** to identify key factors influencing the size of the social care services demand by different categories of population. On the example could be social protection of under-aged children: factor analysis should define why in some Municipalities in particular the number of homeless children, children without parental care or children who survived violence is significantly bigger than in others – and what indicators are worth measuring to evaluate the depth of this problem. In this very hypothetical example, such indicators may include age structure of the population, divorce rates, urbanisation level etc.

2. In the framework of the sociological research and additional statistical analysis, **identify which of the discovered factors do not correlate with the number of population.** Since the strategic task of the formula (in the long-run) is only horizontal re-distribution of funds between local budgets but not calculation of their absolute needs, the key issue for the formula is the comparison of the service demand in different areas with the average demand in the country. The easiest and the most approximate approach is even redistribution of funds per capita – such approach assumes that each person has equal potential demand for the given type of service. Incorporating additional factors as variables would make sense only if we assume that Municipalities of similar population size have some objective difference in demand for social care services. Otherwise – if the percentage of people needing certain service in each Municipality is almost equal – it would be much easier to rely directly and exclusively on the number of inhabitants living in the Municipality. Coming back to the example with the social services for under-aged children, accounting for additional factors makes sense only in the case if we think that Kosovo Municipalities exhibit significant variation in the percentage of such vulnerable children.
 3. Conduct more in-depth **analysis of the identified root factors of vulnerabilities and respective demand proxy indicators by the following criteria:**
 - **Data availability** (whether it is possible to receive regularly data for these factors i.e. is there a regular monitoring of such data);
 - **Possibilities for quantification** (the data should be in quantitative format or they should have opportunity for transformation into quantitative indicators);
 - **Absence of possibilities for manipulations with the variables** (the indicators should be interpreted in the same way by all stakeholders of the process of policy making and practice of social services provision, local authorities should not have direct impact on the level of these indicators);
 - **Neutrality** (indicators in the formula should not create obvious or hidden stimuli for providing services in definite way; the system should be neutral in the ways of service provision rendered in individual community).
 4. Simulate (with the help of statistical modelling) the possible consequences of changes in the formula and discuss it with engaged stakeholders with the aim to search for an acceptable version of reform.
- **Development of transition coefficients.** Depending on the selected length of the transition period, and on the variables which are expected to change in those years (types of services funded; approach to estimation of service costs; approach to estimation of relative demand for services), it should be possible to design a set of transparent transitional coefficient which will clearly show how the transitional elements of the formula will gradually phase out. For example, to incorporate gradual transition from current levels of funding based on existing infrastructure towards funding based on more objective criteria, transitional coefficient may help to allocate additional compensatory amount of funding to potential losers in the initial years of reform, which would be phased out on an annual basis.
 - **Economic assessment of Unit Costs of service provision.** As discussed earlier, on page 22, estimates of the costs of service provision may be required both in order to design earmarked grants for deconcentrated funding of services (e.g. during the transition period) and in order to conduct overall policy analysis and costing of reform options in case of more significant decentralisation. Detailed approaches to Unit Cost estimation are outlined in the Back to Office Report from the project mission in May 2011. Specifically, unit cost assessment for provision of various types of social services may be important if transitional elements of the social services grant would include elements of current approach to allocation of Specific Health and Education grants, which incorporate service cost estimates (such as wages and costs of visits to healthcare facilities).

- **Comprehensive analysis of potential impact.** As was already discussed, an important part of the formula design is impact assessment.
 - **The impact should be assessed based on current and potential budget allocations across individual municipalities.** Impact assessment should be achieved by analysis of current distributions of resources for social services delivery at all tiers of government and in Municipal breakdown, and simulating the potential impact on these current levels against various scenarios and stages of changes in the formula.
 - **The exercise could be helpful to develop additional stimulating grants for winners and losers.** This analysis could also become a basis for designing and testing both – transition rules and coefficients and potential additional matching transfers to run capacity-building initiatives during the transition period which would fund activities to guide potential gainers from reform in terms of ways to use their increased budgets for social services effectively and to support potential losers by compensating them financially and by providing trainings in increasing value for money in service provision without significant expansion in the budgets.
 - **Impact assessment should take into account potential changes in population statistics.** Apart from the impact of potential changes in the formula for funding social services, which require analysis, overall transfer allocations to local budgets are likely to be influenced by the change of population statistics expected with the population census which should be held in 2011.

As discussed earlier, population statistics plays a strong role in the overall distribution of resources across budget as the key indicator within the General Grant. At the same time, this statistics is woefully outdated. The last reliable census was held in Kosovo in 1981; that is, 30 years ago. The more recent 1991 is not reliable since it was not properly implemented in two municipalities in central Serbia and was boycotted by the Kosovar Albanian population; and the 2002 census in Serbia did not cover Kosovo (6). At the same time, during this period the country went through significant demographic change and migration (18). When the population basis of the General Grant calculations changes many municipalities may experience a significant financial shock (26).

Moreover, this expected financial impact from the changed population is likely to against poorer municipalities and in favour of more economically advanced regions. The current allocation of grants relies on the 2001 population figures which were established based on combined statistics available at the time to the UNMIK Department of Local Administration (DLA) and the Central Fiscal Authority (CFA). It is likely that since that time, internal migration has shifted population away from poorer regions to places with stronger economic activities such as Pristina or Prizen. Therefore, current transfers implicitly allocate less funds to these more developed municipalities, with greater local tax potential, than it would have done based on more objective and up-to-date population numbers (6). This could change when the new census data becomes available, and therefore requires specific analysis, statistical simulations and informed policy response.

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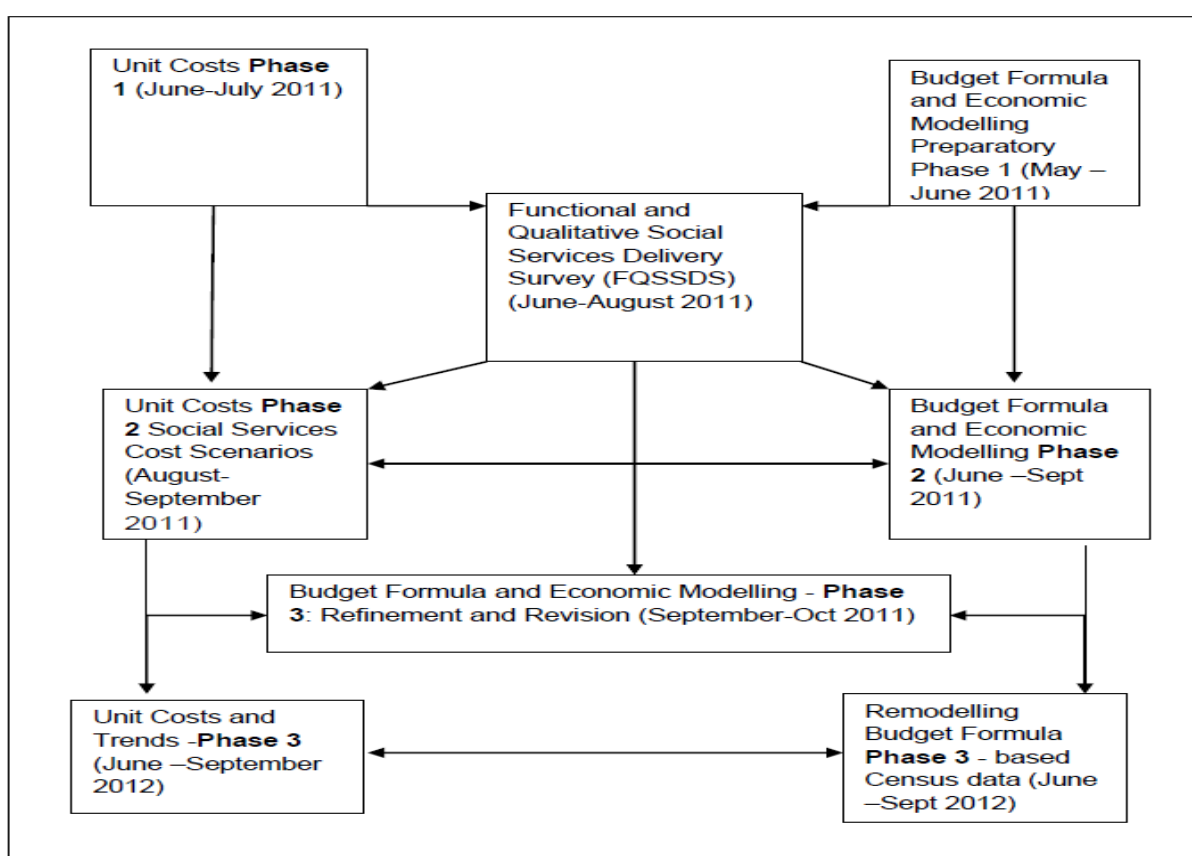
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Annex 1: Methodology and Work Plan for the Completion of the Budget Formula

Three DFID Project activities are critical to the task of designing and completing the budget formula for social services:

- Activity 2.2: Economic Assessment of Unit Costs and Cost Scenarios in Social Services;
- Activity 2.3: Budget Formula for Supporting the Econometric Model of for Social Services Decentralisation
- Activities 3.1 and 3.2: Functional and Qualitative Social Services Delivery Survey (FQSSDS)

The interface and sequencing of these three groups of activities is depicted in the diagram below:



Activity 2.2: Methodology Unit Costs and Cost Scenarios for Social Services

Introduction:

Decentralisation is a process of transfer of services and powers from a state to its municipalities. The provision of new services or the delegation of responsibilities requires adequate financial resources. The shift from hierarchical subordination of municipalities to equal relations with the state implies that the quantity of such resources have to be agreed between policy makers at national and local levels. In order to uphold local interests, the representatives of municipalities should be equipped with knowledge and tools so as to come up with the actual (full) costs for rendering decentralised services. Some of the cost elements are often hidden in other functions (e.g. administrative costs) or they are simply omitted in the negotiation process.

The lack of such information and knowledge has adverse impact on the state transfer system and frequently leads to unfunded mandates for social services at local level.

The new powers of decentralisation create conditions for differences in administrative effectiveness and this affects the distinctions in the financial status of municipalities. This requires that central governments should use increasingly complex mechanisms for financial equalisation. Negotiations with local government representatives imply that the latter should be aware of the cost of the services and of the existing objective differences among municipalities resulting from their specific conditions of service production and delivery. The greater powers of the local governments go hand-in-hand with greater responsibilities to the voters and taxpayers.

An increasingly popular practice is to discuss local issues with the community, to report performance to broader audiences, and to undertake obligations to provide new services. The enhanced dialogue with the population and the transparency of the overall activities of the municipalities requires that the budgeting process should be based on an estimate of the total cost of services. Greater autonomy of municipalities implies possibilities for local decision-making on ways of providing individual social services. It is the obligation of the municipality to ensure the provision of social services either directly or via the commissioning of another body. Depending on circumstances, it is often more costs effective for a service to be outsourced (i.e. rendered by an external provider). In EU member states, and in transition countries seeking accession to the EU, this practice has been common in utilities and recently in the provision of community social services as well. The protection of the public interest in the process of outsourcing a certain service presumes knowledge of the total expenditures for its production and provision

Unit costs can help municipalities with the following objectives:

- **Establish how much the service delivery and administration costs.** When municipalities fund a service from general grant revenue, the administrative costs may be lost among all other expenditures. Even if an effort is made to establish them, some of them may easily be bypassed. Local governments will be able to better control their expenditures, if they know their real cost.
- **See the real picture of their costs in spite of any high and low tides in cash expenditures.** By using such techniques as depreciation, full cost estimation can reveal a more precise picture of the expenditures under municipal programmes without any distortions that might occur if considering only the cash expenditures for a particular year.
- **Explain and publicly account for the actual costs of the service.** Cost estimation will help explain to the citizens how much a delivered service actually costs. This will prompt adequate expectations on their part and, above all, it will equip them with additional knowledge for taking more informed decisions during their direct involvement in the governance of a municipality. Many people believe that public services are free of charge because they pay either nothing or substantially reduced prices for them. It is common practice to determine the cost of municipal services solely on the basis of the direct expenses incurred for them. In other cases the cost of certain services may be overly appreciated. Cost estimation may provide realistic information to citizens as well as respond to specific expectations and suggestions of the public.
- **Assume a more business-like approach to service administration.** By focusing on expenditures, the full cost estimation of a service imposes a more business-like, more corporate approach to administration. The users of goods and services increasingly expect value for money, which means a proper balance between the quality and costs of a service. Full cost estimation may help map out the options for better and more up-to-

date service logistics, for doing away with ineffectiveness and for facilitating activities aimed at savings via planning and decision-making based on adequate information.

- **Enhance their negotiation position vis-a-vis their suppliers.** When considering the commissioning of services through outsourcing, full cost estimation may be used to find out how much it costs (or would cost) to do the job. Full cost estimation may also help municipalities, which provide these services, to determine on their own whether their costs are competitive as compared to the costs of the private or non-governmental sector.
- **Estimate the components of the individual services.** Full cost estimation makes it possible to estimate the net expenditure for each element of the service. Full cost estimation may help avoid common errors in thinking about services, particularly the mistake of treating hidden costs (such as staff training) as non-existent.
- **Improve service administration programmes.** If other municipalities use full cost estimation of a service and report the results, it will probably be possible to draw an inter-municipal comparison of the costs per unit of service. Such a comparison might prompt options for “restructuring” some of the current activities. Moreover, when municipalities are aware of how much it costs them to administer services on their own, they could better identify the possible savings they would generate.

Unit Costs and Social Services

The development of unit costs for social services is primarily designed reflect the perspective of the client and allow staff and service providers to see how clients [children and families, the elderly, the disabled and other groups] are supported and at what cost. Currently the calculation of unit costs in Kosovo for social services is inadequate and focuses only on wages, utility and capital costs to the exclusion of management and administration, staff training etc. The Law on Social and Family Services (2005) is designed to diversify support to clients in a variety of ways through the work of social workers, administrative staff, foster carers, home care workers, and other support staff. In order to discover how much will be spent on meeting the needs of an individual client, it is essential to measure how much is spent on meeting the needs of an individual client in residential and community-based service delivery settings. Municipalities therefore needs to measure how much of each service a client receives, then work out the cost of each amount before adding everything together. This approach will help set the framework for establishing realistic budgets and inter-governmental transfers for the provision of social services.

Once it is established how much an hour of social worker’s time costs [let’s call it **x**] and once it is known, for example, that in a given week a particular client [e.g. a child placed in foster care] receives six hours of attention, then the costs of the social work contribution of meeting the child’s needs during the week would be:

x times 6 hours

If, in addition, the client [for example a child placed in foster care] receives foster care/home care for 5 days a week the cost per day of the foster care is **y**, the cost of foster care is:

y times 5

x and **y** are unit costs expressed in terms of service per hour or day. If the child receives no other services then the total weekly cost of the service for the child will be:

(**x** times 6) plus (**y** times 5)

The algebra is rather crude but it nevertheless helps describe the relationship between a client's needs [in this case a child in foster care], services and costs. The harder part is calculating accurate values for **x** and **y**. The real cost associated with a social worker visiting a client is much more than a proportion of an individual salary plus essential 'on-costs' such as pension contributions and other payroll taxes. It must include the cost of administrative staff, a share of maintaining an office and managing a department and so on. When comparing costs and services, it would not be sensible to argue that one team of social workers is cheaper than another despite having the same number of social workers, if the costs of one but not the other included an allocation for administrative staff, training, travel and so on.

Accurate cost calculation involves knowing how to take account of the various components of an hour of social workers time or a day of residential care. This is always likely to be an imperfect science, but the more accurate all the expenditure categories that contribute to a service are acknowledged the closer the understanding of the real costs and a more fully rounded knowledge of all that providing community-based social services – for children, the elderly, the disabled and other groups – entails. The focus on unit costs is therefore important for elaborating the Law on Family and Social Services for four reasons:

- Identifying and assessing the overheads incurred in the delivery of residential and community-based social services: for example, direct management, departmental support and central services from the MLSW, municipalities, and other departments;
- Identifying the costs that need to be incorporated into the prices that need to be used in the development and definition of contracts for the delivery of social services by non-governmental organisations [NGOs] or private sector service providers.
- The need for mix of social services required to meet a range of client needs, and to assess the relationship between unit costs, marginal costs, and client need in the context of meeting policy goals.
- Provide inputs that will contribute to the design of a budget formula for the allocation of central and local government financial resources to social services.

Assessing and evaluating unit costs within a *Balance of Service* model for social care services is important when a clearer picture is required on total expenditure in particular areas of social care service provision. It is also useful for estimating unit cost performance indicators – i.e. ensuring the scope of activities included in the indicators is the same in all municipalities thus making it easier to compare them – see Table 2 below for an illustrative of the way costs and unit estimations should be structured for a social worker providing community-based services:

Table 2. Unit Cost Estimations – An Illustration

Costs and Unit Estimation	Value [Base Year X]	Notes
Wages and Salary	Value in year X	Information will need to be generated from a workforce survey based on a cross-section of urban and rural municipalities. The value attributed to wages and salary should be the midpoint between the average minimum and the average maximum salary/wage cost.
Salary on costs	Value in year X	Employers contribution to pension and other payroll taxes
Overheads	Value in year X	Information will need to be based on establishing a proportion of the salary costs attributed for management and administrative overheads. Such information will need to be developed on the basis of a cohort study of management and administrative costs attributed to a single social worker
Capital Overheads	Value in year X	This will need to be based on a proportion of building maintenance/utility costs; and administrative/clerical support costs

Travel and Miscellaneous	Value in year X	Cost of using a car or public transport to visit clients
Working Time	Number of weeks per year, and hours per week	This should include allowances for annual leave and statutory leave days [such as public holidays]. It will also need to make assumptions about sickness days and study/training days
Direct client contact	Number of hours spent with individual clients per week [e.g. 1 hour per client per week]	This calculation will need to separate a social workers time spent in direct time on client related activities, which allows an hour spent on client-related activities to be costed. This is not the same as the cost per hour spent with a client.

Unit costs estimations can be made for many purposes, but certain principles will apply whatever the context in which a service is provided:

- They should be inclusive
- They should tally with service use but be capable of aggregation
- They should reflect long-run marginal opportunity costs²
- The data should be up-to-date

These principles are elaborated below:

Inclusive:

Unit cost calculations should include the financial implications of all the components of a particular social care service such as staffing, utilities and maintenance. There will be some support from the organisation[s] providing it, such as a management, payroll or administration. This is the gross total cost to the agency that provides the service. Contributions from other agencies or budgets require attention too; a service may be jointly funded by a labour and social protection department and the education department or the user may pay a fee or charge.

Tally with way services are used:

One client is unlikely to use the whole of social work team for a whole week. A CSW team will usually provide support for a group of clients and each client may see one social worker for only an hour or two. Similarly a client in a residential care institution will be one of group using a particular social service – e.g.; a recreational facility. So unit costs need to be sensitive to how people use services and be specific to the activity that each entails. This similar to the measurement of hospital care which is measured in bed-days [i.e. the number of days a patient spends in hospital], so residential care can be measured in days or weeks. However, this service ‘intensity measure’ is not appropriate for community-based social services; one hour or one contact between social worker and client is more appropriate.

Aggregation:

For many purposes – particularly for an economic evaluation – the estimation of unit costs is only the first step. While it is intuitively right to measure service use and costs for individual clients – because this is how services in community-based social services are provided - the data will need to be added together to make it easier to understand or to inform decision-making. For example, a series of case studies describing a particular group of client’s situations [e.g.; children in need of foster care, or elderly persons in need of home care] and the

² An opportunity costs is the value of the alternative use of assets that have been tied-up in the production of a service.

costs associated with the support they receive over time and from different services or agencies [e.g. labour and social protection, family, youth and sports, education, health] can highlight important issues. If data can be collected for a large enough group of young people, it should be possible to explore the variation in their social services costs and to examine the relationship between needs, activity in response to needs, costs and outcomes. Aggregation of costs data can then, usually quite easily, be constructed for particular groups by age, gender, needs etc.

Opportunity Costs:

Deciding whether to take a short-term or long-term view is a crucial step when estimating costs. A 'marginal cost' is the cost of supporting one extra client and may be calculated from either perspective, but in social services short run estimations are rarely appropriate because they carry with them the implication that more people could always be supported using existing resources. In other words, a policy based on short-run costs would give the impression that however many extra clients require support the current set of services has the capacity to support them. Short-run marginal costs estimated for a residential institution would show the extra costs per resident – perhaps only extra meals, a locker for their belongings etc. But suppose the residential institution is nearly full; there must be a limit to how many 'extra' clients can be squeezed in to the institution. An extra five or six would seriously compromise the quality of care and extra demands on staff.

Long-run marginal cost estimation recognises the financial implications of necessary expansions. Since more is known about the present than the future, it is conventional to approximate long-run marginal costs using short-run averages that include all revenue elements as well as costs of building and equipment [capital] and overheads such as management, personnel or administration.

The need for cost information stems from the imperative to choose between alternatives. Resources are scarce: so should the GoK provide new residential institutions or should it provide support services to help people in their home environments? Either way, the Government will have forgone benefits [lost opportunity] of the next best alternative. Choosing to have more residential care institutions will mean that more children, elderly and disabled people are looked after at the state's expense; but there will be no improvement in enabling people to be supported in the community with the opportunity to lead/maintain as normal life as possible. Thus the opportunity cost will reflect the resource implications of opportunities foregone rather than the amounts spent.

Cost Data:

Unit cost information should apply to the period in which the policy is to be implemented or the service used. Too much delay and services may change making the cost data irrelevant.

Inflation indices are useful if the original information on which unit costs are based is more than a year old but the correct index must be chosen, because service costs often rise at different rates. For example, annual pay and prices for residential based care for elderly people may rise at different rate than for community based services for the same group of clients.

Top-Down or Bottom-Up

There are two approaches to estimating unit costs: one known as top-down, the other as bottom-up. The top down approach assembles all relevant expenditure and divides it by units of activity. The bottom-up approach identifies the different resources tied-up in the delivery of the service and assigns a value to each. The sum of these values, linked appropriately to the unit of activity, is the unit cost of the service.

The top-down approach has the virtue of being relatively simple to apply, and can easily be used as a starting point in discussions about the costs incurred by lower tiers of government

[e.g., municipalities] in the provision of services. It can be very helpful where units of activity can be consistently measured and allocated to expenditure because changes in estimated costs can provide a helpful management tool in monitoring changes in performance and efficiency.

The value of the bottom-up approach lies in the fact that those applying it must grapple with the detail of every element of a service. Consequently, it encourages a good understanding of the services being costed and careful consideration of the relationship between patterns of work in an organisation and the way services are delivered. Bottom-up estimates are far less straightforward to produce than top-down costs, but once assembled are more versatile. They can be used to show where variations in cost are occurring and they can be adjusted to reflect planned changes. Thus for most purposes a bottom-up approach to unit cost estimation is better.

Developing a Costing Model for Social Services:

The development of a costing model for social services needs to be based on building block approach that incorporates four stages:

- **Description** – the ingredients of the service
- **Identification** – the activities and unit of measurement
- **Estimation** – the cost implications of service elements
- **Calculation** – the unit cost

This section describes each of the four stages that could be integrated into the model for the development of unit costs by the GoK.

Description:

Clear description is an important starting point because it helps to ensure that a cost is included for every aspect of a social service. This requires listing items such as building use, the number, salary grade, and working hours of staff in different professions and roles, as well as office services, and travel arrangements. In the process it should be possible to identify what might be called 'hidden costs', such as some expenses paid directly by other agencies.

Expenditure accounts are an ideal basis for service cost estimations, but the variation between the organisation and accounting practices of local government agencies or other service providers means that different elements will need to be included under, or excluded from, 'cost centre' headings. It is therefore doubly important to describe the service in detail, so that completeness of the financial data can be assessed. Accurate description has the further advantage of bringing to light aspects of a service that appear to have no cost – e.g.; might be the provision of a building rent-free to a non-government organisation. Volunteers often appear to be a free resource, but over and above the costs of their training and expenses, there is an opportunity cost to the volunteer.

Identification:

The aim here is to list everything that a service does and to decide upon a unit of measurement that will make it possible to calculate unit costs. For some services, identifying a unit of measurement is a relatively simple matter. For example, young people usually stay in residential care for a certain number of weeks and elderly people, in receipt of home care services, receive these services for a specific number of weekly sessions. Each will have a set number of places and there will often be a capacity indicator [100 per cent capacity indicates there are no spare places]. These are obvious examples of service outputs and provide a logical unit of measurement.

In other cases, facilities that appear to be one thing may actually be responsible for a range of activities: for example, a residential institution may also provide day care for non-residents. Unless these other activities are carefully described and joint costs allocated to them, the 'per bed' cost of the residential home will look far more expensive than is actually the case.

For some facility-based services separating the strands will be more complicated still. For example, a family centre [which provides support to families with children in difficulty] may provide day care for children, while at the same time taking referrals from other agencies and providing a range of recreational facilities to the wider community. Thus taking account for these multi-purpose type service centres may require a number of different units of measurement – one for each element.

A similar challenge may be posed by community-based services [peripatetic services] which can be defined as those social care services delivered by a single member of the CSW staff [who also works as part of team] to individual clients or groups of clients. These clients may be seen at the office of the team but peripatetic staff will also travel to their homes or to other locations [e.g. a hospital, a residential home, or a foster home]. Social workers are the most common example and the most obvious unit of measurement is an hour of social work time. However, many other types of activity apart from face-to-face contact with clients contribute to their workload, for example contact with other professionals, writing-up case notes, planning meetings, or travelling to appointments. Thus, productive work hours [that is hours that a member of staff is contracted to work] will often be less an appropriate measure than a unit – often referred to as 'client contact' – adjusted to reflect time spent on all activities that support face-to-face contact.

It is important to establish an accurate activity measure [numerator of unit cost] as it is to get the total cost figure [denominator of unit cost] right – because without this information it is difficult to determine the unit costs that should constitute the basis for setting the prices and contracting social services to NGOs or other service providers; and for establishing the budgets that are appropriate for services delivered by government agencies. Consistency is obviously vital if unit cost indicators are to be compared across municipalities or between service providers. It is usually possible to assemble a picture of how much of which services each client [e.g. children, elderly and disabled people] uses over a given period, to calculate the unit costs and then to extrapolate the result to find the total cost of providing social services.

Estimation:

This stage is likely to be time-consuming, not least because of difficulties in obtaining service-specific information. Departments that provide services may be reluctant to explain how their budgets are spent, lack the data, or be reluctant to explain costs for innovative social services. Under these conditions explaining the rationale and purpose of assessing unit costs with financial officials and managers cannot be overstressed; the more closely the departments/agencies providing services are involved in the estimations, the more accurate the results.

The possibility that municipal financial systems may not be set up in a way that readily meets the needs of a unit cost analysis and may not be able to generate the data required gives reason for allowing plenty of time for this stage of assessment. In addition, costs data obtained from the providers of social services need to be up-to-date, but this requirement may not fit with the financial cycle. However, in municipalities, residential services, and CSWs cost centre accounting practices can make the task easier, because financial managers are usually provided with monthly updates of a social services' expenditure against the budget. However, for other expenditure components, particularly those treated as internal recharges [e.g. when debits take the form of payments or transfers within a department], the budget may differ considerably from the figures calculated at the end of the financial year.

Calculate:

Once all the information has been collected it will need to be adjusted to ensure that all the service elements have been included and that each component is treated appropriately. For example, the running costs associated with a residential institution [such as staff costs or utilities] are recurrent expenditures and are usually presented annually, but a building in which a service is located is usually intended to last longer than a year and so represents a long-term investment. However, the calculation of unit costs will be easier if long-term investments can be represented in a form commensurate with revenue costs, so allowing total costs to be described as a single amount. The convention for calculating the opportunity costs of capital provides one such solution. For example, it could be assumed the best alternative use of capital would be to invest it to earn interest over an equivalent lifetime of say 60 years. The opportunity cost of capital is therefore calculated as the constant stream of cash payments, or annuity that will deplete the lump sum over the lifetime of the building.

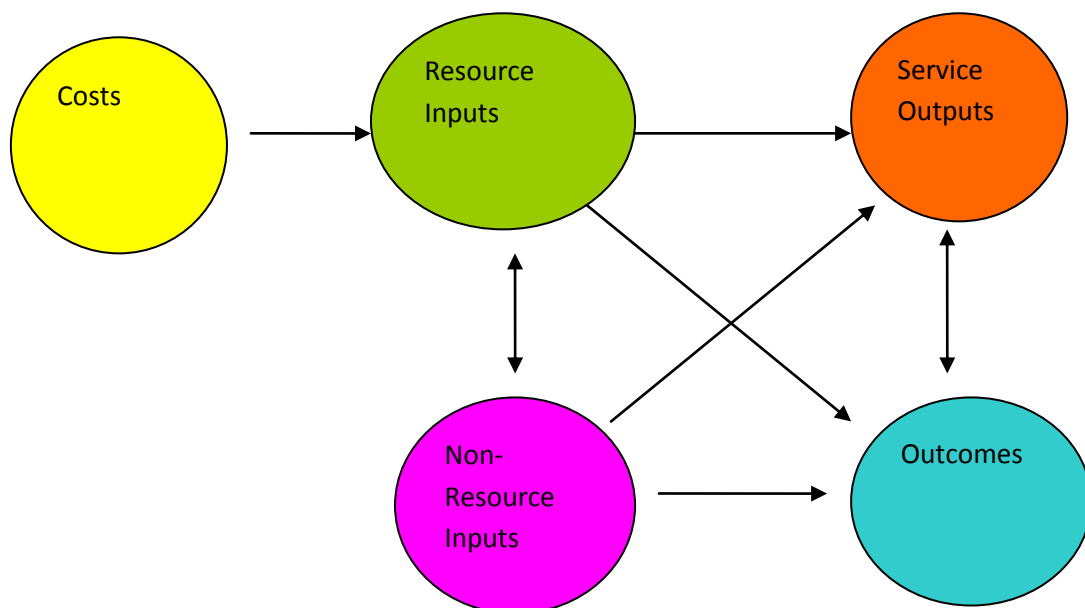
Like much else, information on capital costs may be presented in different ways by different tiers of local government, but it is important that depreciation figures for items that diminish in value over their lifetime – for example furniture or computer equipment. Thus it is essential to employ the most appropriate figure. The final task is to make a careful amalgamation of the information from the *identification* and *estimation* stages of the model. The aim is to calculate a relevant unit cost for each service or activity with a particular type of social service as the best estimation of the long-run marginal cost. This can be achieved by adjusting the total cost of the service to reflect the unit(s) of measurement identified. It is expected that clients supported by social services will use more than one service [e.g. an elderly person may use home care and recreational facilities, or a child in need of care and protection may use a foster home and psychiatric/counselling support]. To be able to assemble a total cost of support for each type of client, their use of different services needs to be recorded, then a unit cost estimated for each service and the figure adjusted to reflect the frequency and duration of use by each client.

Costs and Economic Evaluation:

The outline of a model for assessing unit costs has so far only touched on some aspects of the methodology. This section takes the analysis a little deeper and suggests ways of measuring what at first glance might be thought to be not amenable to measurement. As described this far, the cost linkages might be represented in the following form:



However, the Law on Family and Social Services is not only concerned with service activity it is primarily concerned with social care services having a positive impact on the lives of clients and their families. The aim is to improve their welfare – through measures that will reduce social isolation and social exclusion, improve relationships, and promote physical and social well-being. Diagrammatically this more human picture of social services can be presented in the following form:



This representation is known as the **production of welfare model** which can be summarised in the following manner: the *resource inputs* are the labour and buildings and equipment [capital], which comprise the social service and can be summarised in monetary terms as costs. The intermediate *outputs* [i.e.; the level of activity generated by a service] can be measured as the level of provision, turnover, or volume of services provided. *Non-resource inputs* are less easy to measure but help explain vital differences between ostensibly similar services. They can include the social features of the care environment and the characteristics, personalities and attitudes of managers, staff and clients. The *outcomes* of the system are changes in the welfare of clients and their families [e.g.; less isolation, better life prospects, less exclusion, less poverty]. Maintaining a focus on individuals means that the system of social services delivery is less likely to forget that different clients will respond differently, even if they receive similar combinations of resource inputs.

The production of welfare model underpins much economic evaluation of social care services. It provides a structure, explain, justify and clarify why certain data needs to be collected and certain types of analysis undertaken and it can help policy makers, managers and staff to interpret results more sensibly. Given that the components are well defined, the links that can sensibly be made between them can also be indicated. For example, there is an obvious causal link between resource inputs [summarised by costs] and the final outcomes [or products] of the social services provided to different groups of clients, but this relationship will be mediated by the intermediate outputs and the different combinations of non-resource inputs.

Phasing the Unit Costs Tasks

The assessment of Unit Costs will be conducted in three phases and will provide inputs that will contribute to the design of a budget formula for the allocation of central and local government financial resources to social services.

Phase 1:

(i) An Assessment of the actual allocation of financial resources at central and local levels in the domain of social services for the following *categories*¹ of Social Services provided by CSWs for

¹ These *categories* are used in order to help standardise the assessment of unit costs and is designed to fully incorporate the list of client groups that have to be provided with social services under Article 1.3 of

the years 2008-2010. The assessment will focus on the social services **Gate-keeping system**² – that takes into account professional staff time and wages for inputs into (i) initial assessment and intake tasks, (ii) referrals, (iii) individual case management - including liaison with courts, prosecutors and the the police, family visits, health services, education services etc (iii) case reviews, and (iv) client discharge. Professional Staff in municipal Centres for Social Work (CSW) usually perform one or more of these core gate-keeping tasks in the context of providing social services. The gate-keeping functions will therefore be assessed for the following services in **Prizren** and **Pristina**:

- **Residential social services** for children, elderly, and people with physical and/or educational/learning disabilities³ in institutions that fall under the mandate of the MLSW and/or municipal DHSW.
- **Community support social services** – including a day care service for the elderly, a home care service for the elderly, a shelter or refuge for victims of domestic violence or human trafficking; a day care service for children with disabilities; a day care service for adults with disabilities; and juvenile offending services
- **Family based alternative care services** – including foster care, guardianship, and adoption (national and international). This assessment will include the task of assessing and appointing families capable of being guardians and adopters.
- **Commissioned social services** – this will include the management and administrative costs of any social services that are paid for, or commissioned by, CSWs or municipalities but are provided by local Non-Governmental Organisations (NGOs).
- **Civil registration services** – including compilation and certification of public documents e.g., for citizenship, identity documents for eligibility to public services, notarised consent, social housing registration etc.

(ii) Calculations⁴ for the above *categories* of social services will take into account:

- The *recurrent* and *capital* costs of all components of a social service – including utilities, staff training, and goods and services;
- Professional social services staff-client ratio's in CSWs by total number of social services cases;
- Professional staff-client ratios in residential institutions;
- Professional staffing ratios in CSW's per head of population in the municipality
- The way in which the above *categories* of social services are currently structured and used by clients;
- Any user charges (such as co-payments) for social services e.g., for residential or day-care social services;
- Unit cost data by age and gender;

the Law on Social and Family Services (2005). The data base on social services held in the MLSW is based on a mixture of types of clients, types of services, and types of activities. The data base therefore has limited utility for assessing unit costs that take account of gate-keeping systems.

² *Gate-keeping* is the system of decision-making that guides the delivery and management of social services to people *in need* as defined by the Law on Social and Family Services (2005).

³ Under existing agreements between the the Ministry of Health (MoH) and the Ministry of Labour and Social Welfare (MLSW) the costs of providing residential services are split: with the MoH holding responsibility for clients with mental health problems, and the MLSW holding responsibility for clients with physical and educational/learning disabilities.

⁴ The calculations will need to take account of the current value of the budgets for 2008, 2009, and 2010 and expressed in constant 2008 Euro, using the CPI – Consumption Prices Index for 2009 and 2010.

iv) Based on the unit cost assessments undertaken in Pristina and Prizren, estimates will be made of the unit costs of each *category* of social service and its sub-service type for each municipality in Kosovo, and at the aggregate (national) level. These estimates will be on analysis of client case load data held on the MLSW social services data base.

(v) The EU project of Support to the Ministry of Labour and Social Welfare⁵ is developing 5 functional and structural standards for social services. This task will focus on assessing the extent to which unit costs can be estimated from the standards that are being developed, and the extent to which these standards can be monetised into financial units.

Phase 2:

This phase will be draw on outcomes from Phase 1 and outcomes from the Functional and Qualitative Service Delivery Survey (FQSDS) which is being conducted in 5 municipalities under output 3. The emphasis will focus on modelling cost scenarios for improving the coverage and quality of gate-keeping in social services that are aligned with key aspects of social services delineated in the MLSW Sectoral Strategy (2009-2013) the accompanying Sectoral Action Plan (2011-2012/13).

Phase 3:

(i) Estimate trends and structural changes⁶ in the socio-demographic groups from which users of social services originate (children, elderly, and disabled). This will be based on available population/census data and/or most recent UN population estimates (median variant);

(ii) Based on Construct three scenarios⁷ to 2020 that establish the likely demand⁸ for social services for the following categories: children in residential and foster care; elderly people in need of care; disabled people in need of care. The scenarios will use the number of children, elderly people, and disabled people in receipt of these specific social services in 2010 as a proportion of the total population of each of these groups; and

(iii) Build assumptions about demographic and macro-economic changes that will drive demand for social services to 2020 and the likely costs implications.

Provisional Scheduling:

- Phase 1 will be completed by mid July 2011.
- Phase 2 will be completed by early-September 2011
- Phase 3 will be completed by September 2012⁹

⁵ The analysis **will not** take into account regulatory sub-systems for monitoring, licensing and inspection given the absence of financial and administrative related components/requirements for the performance of these functions within the social services regulatory system.

⁶ This is aligned to data requirements for inputs into MTEF planning and will enable central government to plan future fiscal allocations for social services based on socio-demographic

⁷ Scenario 1: flows of children, elderly and disabled into formal care will be determined only by demographic changes, and the rate of demand remains constant; Scenario 2: changes in demand will result from demographic conditions and the general economic situation; Scenario 3: demographic and macro-economic changes as well as changes that will result under different per capita ratios (per head of population and per head by age profiles)

⁸ Demand for residential and/or foster care depends on the number of children in Kosovo and the rate of entry into residential or foster care; likewise the demand for elderly care services will depend on the number of older people and the rate of ageing.

⁹ The completion of this phase is predicated on the planned release of census data in June 2012

Activity 2.3: Budget Formula for Supporting the Econometric Model of for Social Services Decentralisation

(The background, framework and initial options for this Activity were elaborated in the main body of this paper)

Phasing of Tasks for the Design of the Budget Formula:

Phase 1: Preparatory – this phase focuses on (i) preliminary diagnostics of inter-governmental fiscal relations; (ii) assessment of data sources and data availability; (iii) options for the design of the budget formula to guide the allocation and distribution of financial resources for social services within the municipal general grant; (iv) the development of an outline of the methods that will be deployed to facilitate the design of the budget framework; a delineation of the variables that will be of strategic and operational significance to the budget formula for social services – including a review of existing features within the formulas used to allocate resources to the municipal general grant, the earmarked pre-university education grant and the earmarked health care grant (May-June 2011).

Phase 2: Budget Modelling and Simulation – this phase focuses on (i) data file collection from Household Budget Survey (HBS), Ministry of Labour and Social Welfare (MLSW) for 2008-2011 and social services data base, and Ministry of Finance (MoF) budget outturns for 2010; (ii) development of budget formula options based on analysis of data files; (iii) initial presentation of options to NPAC in September; (June-September 2011).

Phase 3: Refinement and Revision – this phase is linked to outputs from the Functional and Qualitative Social Service Delivery Survey (FQSSDS) – which is being implemented under Output 3 - and outputs from phases 1 and 2 of the unit costs/cost scenarios. Tasks will include the incorporation of feedback and technical comments on the budget formula from NPAC, and feeding in ideas/approaches to the Annual Social Services Conference scheduled for September (September –October 2011).

Phase 4: Finalisation of the Budget Formula and the Interface with Cost Analysis: - this phase will elaborate on the budget formula model and undertake sensitivity assessments linked to equity and efficiency, impact assessments of various variables and weightings, and presentation of final draft model (October –December 2011).

Activities 3.1 and 3.2: Functional and Qualitative Social Services Delivery Survey (FQSSDS)

Introduction:

The FQSSDS will focus on relevant institutions involved in the delivery of municipal social services and the interface social care services have with the police, the courts, probation, education, health, employment, and civil society actors across 5 municipalities. An initial review of key municipal level institutions is crucial for ensuring better links are established between policy, planning, and budgeting. The FQSSDS will review existing service delivery plans, leadership and management styles, integration of social policy issues into local municipal strategies, patterns of service delivery, coverage patterns, resource flows, risk management and prioritisation of services based on need, level's of inter-agency co-ordination across local services in rural and urban areas and minority municipalities, district-level human and financial resource constraints, the views of a cross-section of different types of social care service users, assess the importance of gender, age and ethnicity in the context of poverty and social exclusion, and utilise this information to promote and develop practical cost-effective measures for developing LSCSS at the municipal level.

Approach

Proposed structure of FQSSDS will consist of six main areas:

1. **Activities** – in order to analyse how social services are delivered it is necessary to collect basic information on scale of social services delivered by all institutions involved. Thus it is necessary to analyse number of cases, scope of delivered services, especially in the context of the needs assessment. It should also identify situations when availability of delivering of social services is limited (e.g. due to lack of necessary infrastructure).
2. **Organisation** – this element of functional review will provide information on structure of main institutions, approaches to management, cooperation with main stakeholders, division of responsibilities (both inside each of the institutions and among main stakeholders).
3. **Processes** – in this element of the research focus will be on main process in organizations: planning, monitoring, controlling, evaluation, budgeting.
4. **Functional Dimension** – in this field main attention will be paid to case management in social services delivery. The emphasis will focus on how the processes for the delivery of social services are structured through different stages: identification, assessment, planning, delivering, monitoring and ending. The analysis will provide information on time requirement on each of the stages and also number of staff involved.
5. **Structural dimension** – in this area research will focus on description to what extent current structures are prepared for the delivery of social services at local level. It will focus on three main elements: staff (number of social workers involved, their competences and human resources management, scope and division of tasks), office and space for social services delivering, equipment (ICT, vehicles).
6. **Quality Assessment** – functional review should provide knowledge also on qualitative dimension of social services. It is propose to base assessment on general principles of quality of social services instead of precise standards or criteria. Quality assessment will focus on such aspects of social services as:
 - a. Availability and accessibility,
 - b. Person centered, comprehensive, continuous,
 - c. Outcome oriented.

Proposed construction of the scope of the analysis assumes that starting point is a description of actual situation (in terms of activities, organisation, processes) which provide the necessary context and also an explanation for how social services are delivered (functional and structural dimensions) and finally qualitative assessment of the delivered services, which focus more on results of the social services delivery system then abstract criteria of quality.

All proposed elements of functional review may be treated as potential explanatory variables for general assessment of social services delivery. The analysis will provide information on two levels: how is current situation in terms of social services and what is the optimal level of resources required for the delivery of social services. The Report will provide necessary input information required for the development of cost scenarios and will complement the unit cost assessment.

Provisional Scheduling:

- Methodology for the research will be prepared by the end of June 2011.
- Field research will conducted by the end of July 2011
- Final report will be prepared at end of second week of August 2011.