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Public Sector Wages: The Implications for the Private Sector

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Public Sector Wages: The Implications for the Private Sector

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05/06/2017

Supervisor: Venera Demukaj

Submitted to RIT Kosovo as part of requirement for education

An Honors Society Project
Presented to the Academic Faculty

By

Drenusha Berisha

In Partial Fulfillment of the Requirements for Membership in the
Honors Society of RIT Kosovo

Abbreviations

OECD- The Organization for Economic Cooperation and Development

SNA- System of National Accounts

EU- European Union

MPA-Ministry of Public Administration

JIAS- Joint Interim Administration of Kosovo

SME-Small and Medium Enterprises

IMF - International Monetary Fund

KFOR – Kosovo Force

KAS – Kosovo Statistics Agency

KPA – Kosovo Property Agency

MTI-Ministry of Trade and Industry

BSPK- Union of Independent Trade Unions of Kosovo

GDP- Gross Domestic Product

Abstract

Acknowledging the contribution of public sector in the well-being of every country, this project focuses on the potential effects of a growing public wage bill for private sector in Kosovo. The public sector is the main employer in the country, where the increase in the staff size is also followed by wage increases which are mainly election induced. While government spending and employment can be considered as complements to private sector as they provide the infrastructure for private sector activity, they can also induce adverse effects. As such, the goal of this project was to provide an analysis of private sector given the raise of the public wage bill in Kosovo. Additionally, this project was to evaluate the effectiveness of the wage increases in public sector, with a special focus on the education sector. Based on the outcomes of such analysis, I provide recommendations as to how to provide assistance to private sector as the sector that has the capacity to trigger growth and development. The recommendations were made as to suggest that policy makers in Kosovo need to employ mechanisms that will create a favorable environment for an effective public and private sector, and as such avoid wage increases as instruments to win elections and silent the labor unions.

The project followed a combination of qualitative and quantitative analysis approach. The focus of this project was the analysis of existing data regarding the size and wages of public and private sector. One public high school, two private companies and the Union of Independent Trade Unions of Kosovo were subject to analysis. One limitation to this project was the lack of data especially for private sector, as many companies hesitate to provide data regarding the compensation they offer. Therefore, 5 interviews and a survey were conducted to collect data that could not be obtained otherwise, and in so doing get a better understanding of the outcomes of the public wage increases for private sector.

The outcomes of analysis show that the public sector has increased its size in the economy with no significant improvements in performance or service delivery. The evaluation of the interactions between the growing public sector wage bill and private sector appears to suggest that the latter suffers from insufficient skilled labor supply,

pressure to increase wages, higher employee turnover and direct difficulties to compete with public sector.

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I. Problem Statement

A crucial portion of Kosovo's employment is in the public sector, government being by far the main source of employment. Throughout years Kosovo's people have witnessed public wage increases, but such wage increase has been mainly election inspired ("IMF Survey" par.11). It is concerning to know that the decision to increase the salaries of public servants has not necessarily been based upon a long term plan, especially when taking into account the possible outcomes of such decision. The wage increases are not part of a well thought long run policy but rather the salary increases are triggered by labor union strikes or elections. This creates the idea that the government is finding a temporary solution, therefore failing to address the root causes of the problem permanently. Public sector wages are higher than the public wages in neighboring countries, and as such have grown three times faster than nominal GDP ("IMF Survey" par.3). Consequently, developing competitiveness and creating more jobs requires reduction of the wage bill ("IMF Survey" par.4). It is by no means an aim of this project to suggest that the wages of the public servants are too high or higher than they deserve. The primary objective is to emphasize the consequences of the changes in public sector wages considering the current economic situation in the country. Kosovo does not have the economic capacity to offer wage increases every time elections are announced because this can damage the private sector, as well as the economy as a whole.

Public sector wages may impact the private sector through various channels, and this project aimed to identify the possible effects of public sector wages on the private one. Considering that in most developed countries private sector plays a crucial role in promoting growth and development, this project expected to provide information that suggests that Kosovo should shift emphasis to the private sector as well. To reach this objective, information were collected to gain understanding regarding the effectiveness of the increase in wages in the public sector with a special focus on the educational sector, as a rising public sector wage bill may not be associated with productivity improvement. Additionally, the spillover effects of public sector wage bill in private sector employment and investment were identified.

II. Literature Review

Concepts and Definitions

There is a general agreement among scholars that public sector is of crucial importance on the performance and well-being of every country. A definition of what public sector constitutes provided by Sabine explains this sector as following: “the public sector consists of governments and all publicly controlled or publicly funded agencies, enterprises, and other entities that deliver public programs, goods, or services” (2). As such, nonmarket government-owned entities and corporations that are under the control and ownership of the government are part of the public sector. In addition, the public sector is divided into the general government sector and the public corporation sector. The former usually includes non-profit institutions that are financed by the states, while the latter refers to the institutions that produce for the markets but are as well financed and controlled by the state (Sabine 4). On the other hand, individuals employed on the public sector are divided as civil and public servants. Civil servants refer to workers of the public sector that are employed in government departments, while public servants are the ones that give their contribution in the education, healthcare or other similar sectors (Sabine 4).

Private sector, on the other side, is considered to play a crucial role in promoting growth and development, and especially developing countries tend to shift emphasis on this sector as an engine of sustainable and inclusive economic growth (Peschka 3). Defining the private sector is considered to be essential in reaching any understanding of the role of the private sector in any development policies. However, an official definition that results in absolute consensus has not yet been provided. Nonetheless, one broad definition may explain the private sector in the following way: “Private sector is the part of the economy that is not state controlled or owned. The sector is also known as citizen sector because is run by private individuals or groups who seek to generate and return the profit back to its owners” (Peschka 2). Workers are employed in the private sector through corporations, nongovernment agencies or individual business owners. Mark Malloch, a representative of UNDP highlights: “The private sector is where much of our focus is going to have to be to meet the overarching challenge of poverty reduction and human development” (UNDP 13).

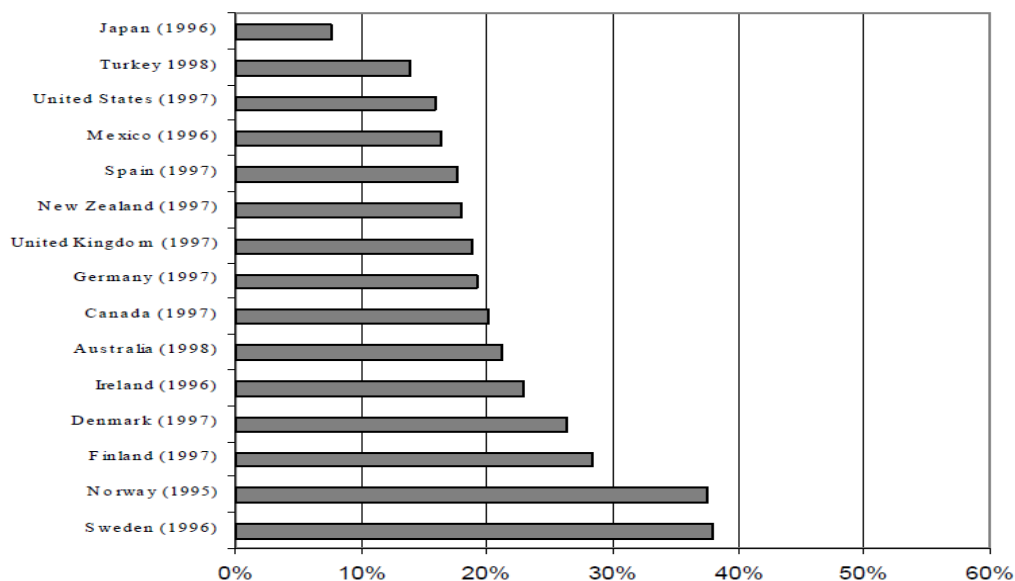
Thus, many argue that growth and job opportunities belong in the private sector, and such job opportunities are not in the gift of the government.

Public Sector Importance

The role of the public sector in the economic reality throughout the world remains unquestionable and no one disputes over its importance on the economic outcomes of states. Even though the effects of globalization and the transition to market economies have shaped new sets of values and approaches, the public employment remains highly important for the economies of many states. The number of workers that give their contributions in the public sector is one indicator of the importance of this sector. It is considered that over 450 million people are directly employed in the public sector, where at least 200 million work in government units (Hammouya 15). The share of public employment in developed countries is around 22%, while in developing countries it is considered to vary from 8-30% (Hammouya 22).

As illustrated in Figure.2.1 the size of the public sector as indicated by the share of employment varies from less than 10% in Japan, up to close to 40% in Sweden and Norway.

Figure.2.1. Share of public employment in total employment in 15 OECD countries

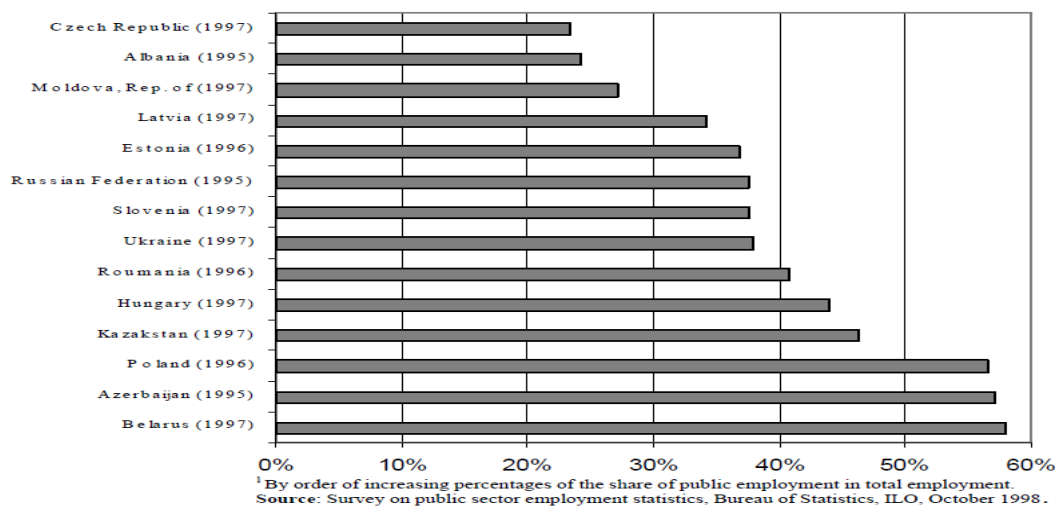


¹ By order of increasing percentages of the share of public employment in total employment.
Source: Survey on public sector employment statistics, Bureau of Statistics, ILO, October 1998.

Source: http://www.ilo.org/public/english/bureau/stat/download/wp_pse_e.pdf

On the other hand, the Figure.2.2 indicates that the share of public employment in transitioning countries is very high, and it varies from around 30% to around 60%; thus, the size of public sector is much higher than in developed (OECD) countries presented on the previous figure (fig.2.1).

Figure.2.2. Share of public employment in total employment in 15 countries in transition



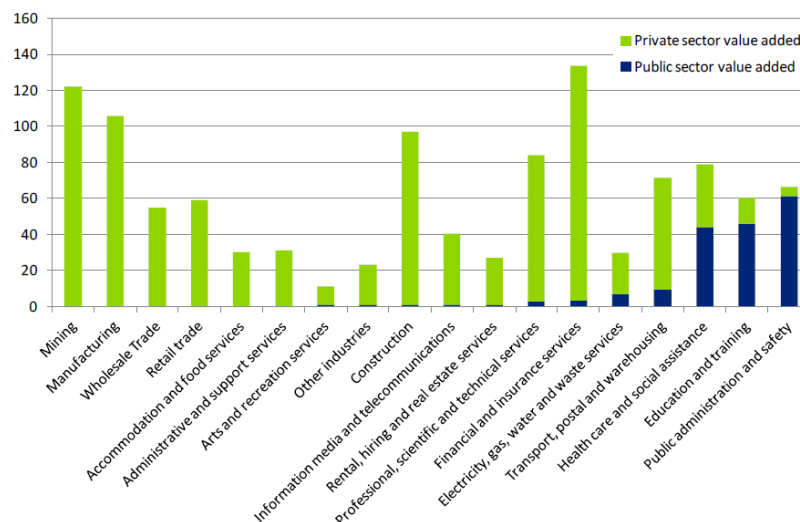
Source: http://www.ilo.org/public/english/bureau/stat/download/wp_pse_e.pdf

In addition to being the biggest employer, the public sector importance lies in its determination of the well-being of the society. In most economies public expenditure forms a crucial part of the GDP. Through political processes the public sector decides on the outcomes it wants to achieve and various interventions it wants to undertake (Dougherty 17). As such, here are included: the delivery of goods and services, redistribution of income etc. Therefore, the role of government in promoting fairness and order is of crucial importance. Effective governments provide pressure for improving public sector performance; thus, leading to more effective implementation of the interventions, and ultimately to better service delivery where people’s lives are substantially improved.

Private Sector Importance

The primary role of the private sector is to generate income by the produced goods and services that can be sold in the market place, unlike the public one that redistributes such goods and services produced by the private sector. The importance of private sector may be indicated by: identifying the private sector’s share of aggregate value added throughout countries, the contribution of the private sector to the costs of public sector activity, and the private sector’s share of national employment (Lienert 17). The impact of the private sector development in economic growth and its influence on eradicating poverty is currently the base of national development plans for several countries throughout the world. It is considered that private enterprises contribute in the provision of employment opportunities for the poor, and in so doing create conditions for better standard of living (KIPRA 5). The private sector development appears to also contribute in the reduction of corruption, which especially in developing countries tends to have reaching implications for both economic and social lives of people (KIPRED 8). Additionally, private sector development helps the engagement of individuals in decision-making processes in an economy. The private sector’s share of aggregate value added for many developed countries appears to dominate over the public sector’s share. For example, Australia as a developed country can be used to illustrate the contribution of the public and private sector to the gross value added, presented in Figure.2.3.

Figure.2.3. Gross Value Added by Sector and Industry in Australia

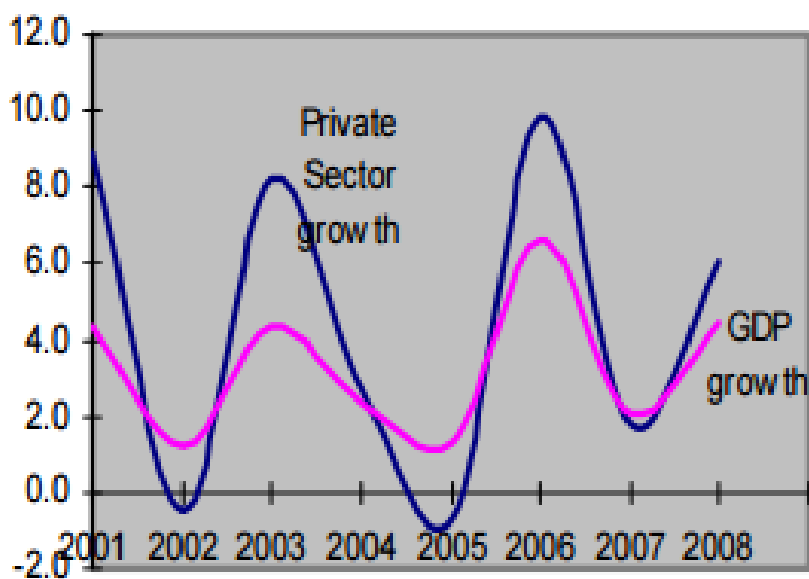


Source: <http://www.companydirectors.com.au/~media/resources/director-resource-centre/research/dae-aicd>

All the required funds to finance the activity of the public sector are transferred from the private one through taxation, except the revenue that is generated through government business enterprises or interest on investment overseas (Telegdy 6). The Australian Government Budget Paper 2010-2011 indicate that around 91% of all revenues are raised by taxing the private sector, where around 87% of this revenue is generated through direct taxation of individuals and companies in the private sector (22). Yet, even the taxes paid by the public sector workers in the general government sector are indirectly generated from the private sector, given that the wages of these employees are funded from the revenues raised from taxes of the private sector activity. Therefore, it seems logical to argue that almost 100% of general government revenue is transferred from the private sector.

Another example, Lesotho, one of the poorest countries of the world can be employed to depict the relationship between the private sector growth and the growth of economic activity. Figure.2.4. portrays the co-movement of the private sector growth and the overall economic growth. As shown, the private sector grew at around 10% in 2006, and during that period GDP recorded a 6% growth; thus, the largest economic growth was encountered when private sector growth was high as well (Central Bank 12).

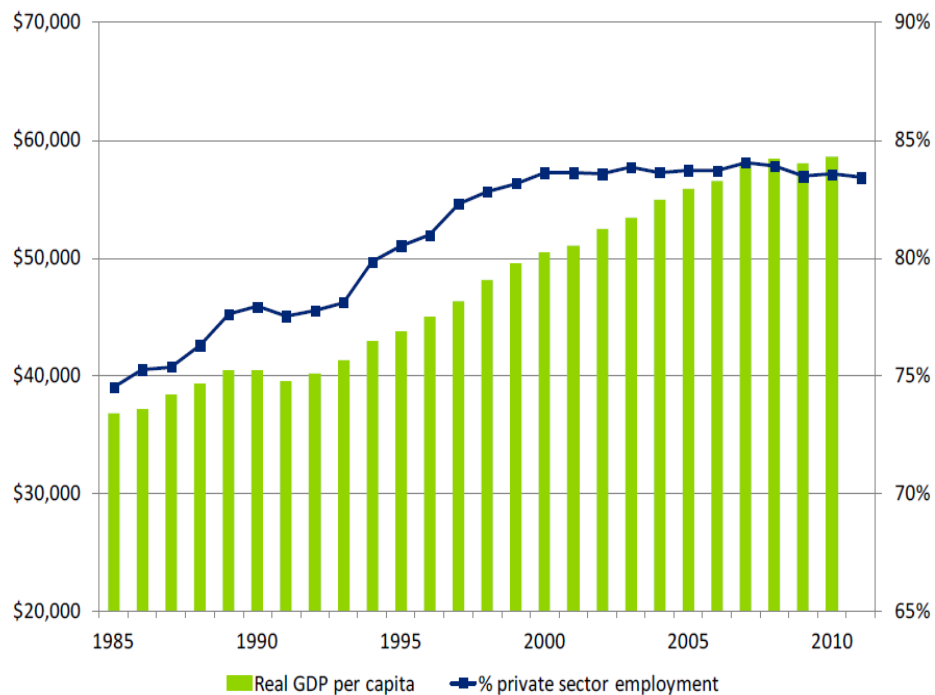
Figure.2.4. Private Sector Growth and GDP in Lesotho



Source: http://www.centralbank.org.ls/publications/MonthlyEconomicReviews/2009/Econo_Review_Nov_2009.pdf

The employment share of the private sector can be used to portray the importance of this sector. Australia can again help to mirror the importance of private sector employment, where in this country the majority of salary earners, around 83% are employed in the private sector. The Figure.2.5 below presents the share of private sector employment and the real GDP per capita in Australia. The share of employment of public sector has declined while many workers have shifted to the private sector, and this has been associated with a stable rise in per capita GDP (Deloitte 9). Thus, this better reflects the views that the labor productivity in the private sector is higher, which triggers improvements in general living standards.

Figure.2.5. Share of private sector employment, and real GDP per capita, 1985-2011



Source: http://www.companydirectors.com.au/~media/resources/director-resource-centre/research/dae-aicd-report_16032012_final.ashx?la=en

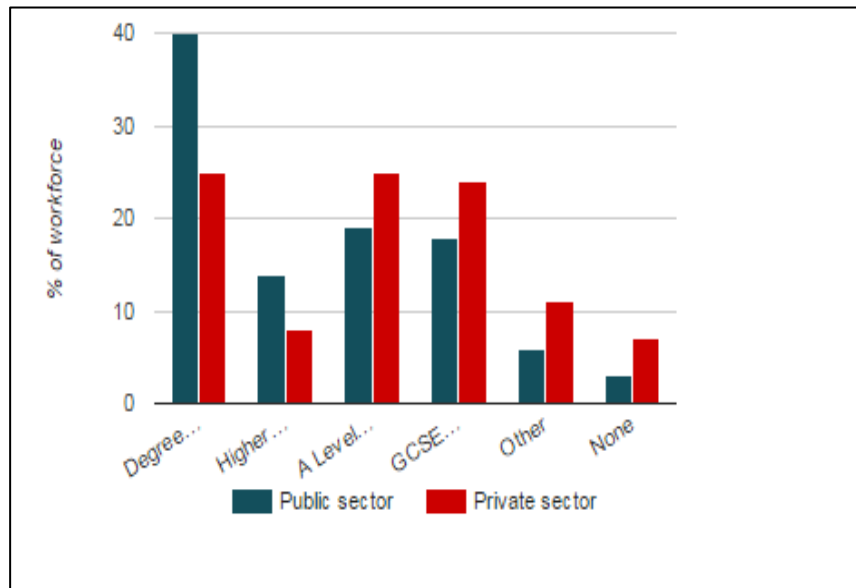
Public vs Private Sector Wage Differentials

Public sector employment patterns and wages have grabbed the attention of a considerable number of researchers; yet, there has been a lack of curiosity on understanding public labor markets in Central or Eastern Europe (Martin 2). The % share of total employment in public sector in these countries tend to surpass the % share in the OECD countries; thus, it is considered that this phenomenon has lacked attention, and as a result the public sectors in these countries are not reformed and consequently the effectiveness and productivity that is expected by this sector is not as high (Martin 9).

Public wage spillovers represent an important component of the distribution of wages, and as such are considered to exert influence upon private sector. There are certain channels through which public sector wages shape the way private sector functions. It is considered that the disproportionate rise of public wages that trigger spillover effects on wage rises of the private sector may induce economic imbalance (Boynec 13). Such economic imbalance can reflect on the country's competitiveness, exports, and economic growth at least in the medium-to long term (Boynec 14). Usually when accounting for differences of earnings in public and private sectors a number of factors are included to identify the differences. These include: skill level, occupational differences, age, gender and qualifications.

The comparison between private and public sector average salaries is heavily complicated by demographic differences between the two sectors. In addition, there are a number of occupations in the private sector that do not have an analogue in the public sector, and this increases the difficulty of making comparisons (Damant & Jenkins 8). It is considered that existing jobs in the private sector require lower levels of education and tend to attract younger employees; thus, the combination of such factors affect the private sector pay. On the other hand, workers of the public sector are expected to have higher levels of education, therefore, increasing the average pay for the public sector (Damant & Jenkins 7). On average, public sector employees are twice as likely as their counterparts to have at least a bachelor's degree (see Fig.2.6).

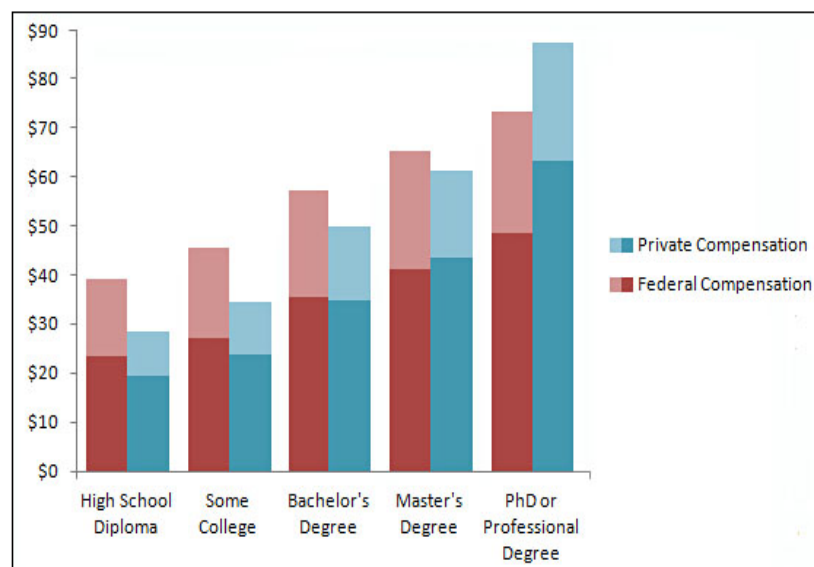
Figure.2.6. Education level for the employees of the public and private sector



Source: <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/>

However, individuals that are most highly qualified get a lower compensation in the public sector, where evidences in UK show that those with degrees get 4.1% less in the public sector than in private one (Alfonso & Gomes 14).

Figure.2.7. Private vs. Federal Compensation

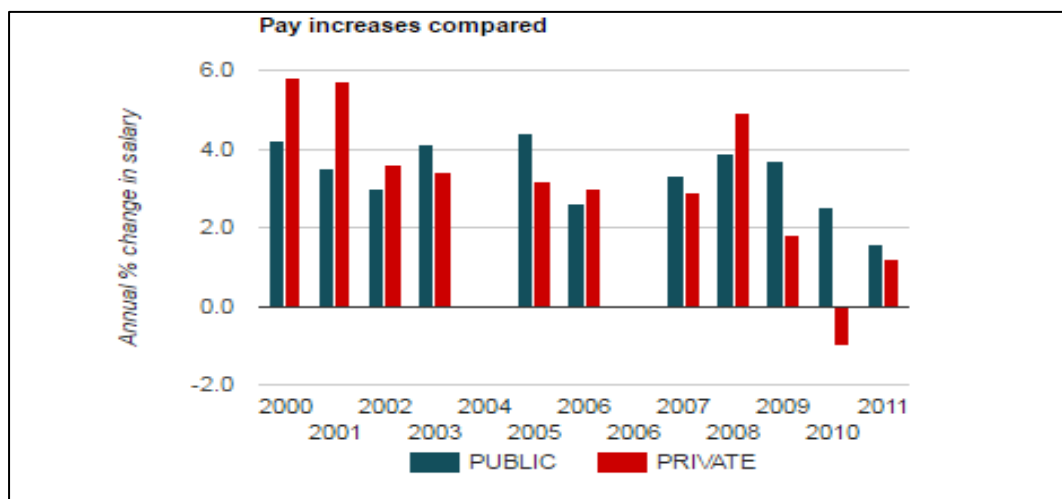


Source: <http://www.motherjones.com/kevin-drum/2012/01/chart-day-federal-government-pay-vs-private->

In addition, age is another factors listed as a very important factor that influences employee compensation; thus, the older the employee is the higher his/her salary is expected to be. Therefore, the graying of the workforce in the public sector may be one variable that explains the sector’s higher wages (Bewerunge, & Rosen 8). Also, benefits provided at the public sector tend to be higher when compared to the private one. On the basis of the evidences currently available, benefits account for around 35% of employee compensation, while around 30% of benefits are accounted for the workers compensation in the private sector (Biggs 9). A major difference is triggered by the health insurance and retirement benefits that are received by workers of both sectors. Employees in the public sector are the ones that are more likely to receive these benefits; consequently, around 51% of the private sector workers are provided with health insurance compared to 78% of the public sector. As expected, also the retirement program is less participated by private sector (84%), compared to 96% of public sector employees (Biggs 11).

As the skill level increases, so do earnings, and based on the report of the Office of National Statistics, a larger number of high skilled workers in UK are employed in the public rather than private sector. This explains the wage gap between private and public wages. However, even though the salaries in the public sector have stayed ahead of the private one, in terms of the annual % pay increases, private sector tends to outpace the public one (see Fig.2.8).

Figure.2.8. Pay Increases in the private and public sector



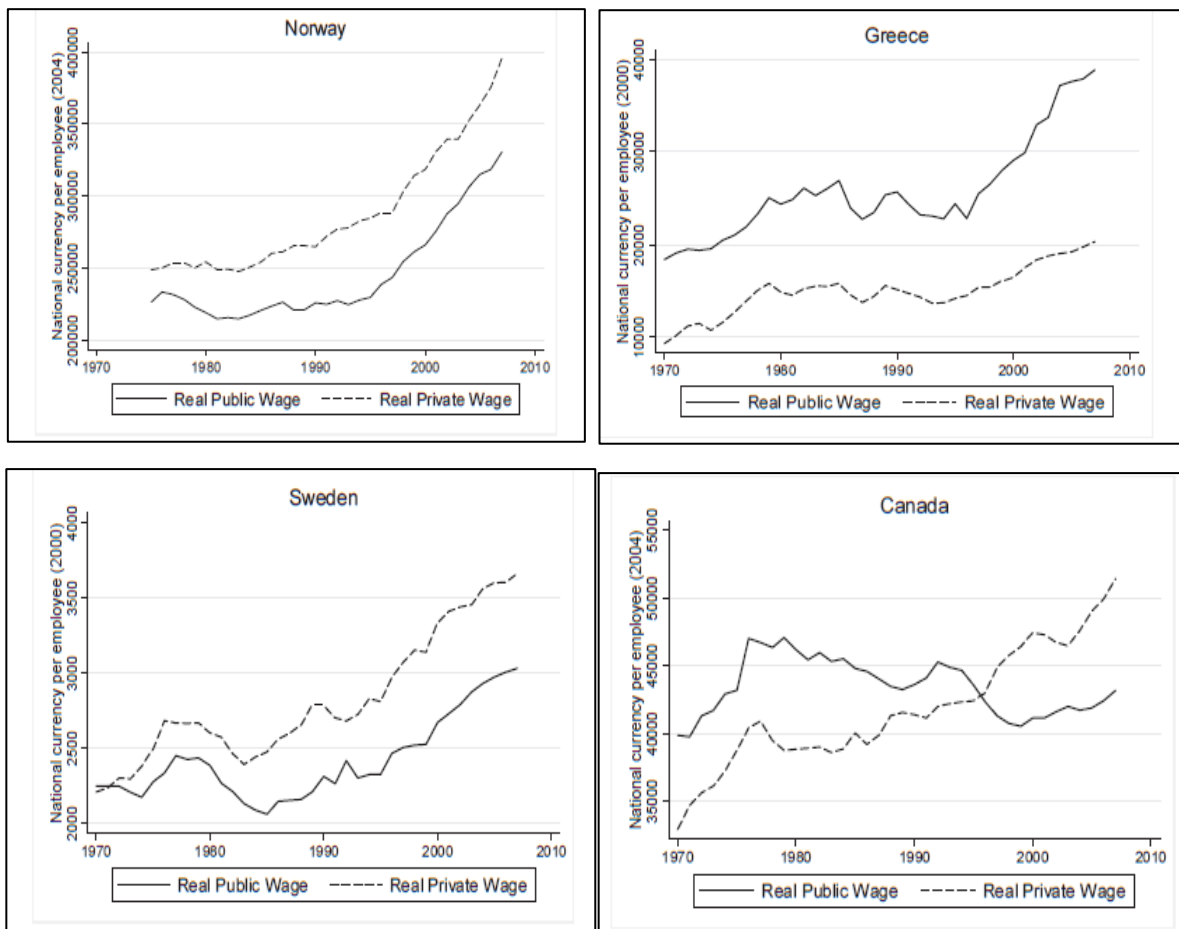
Source:

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/>

Public vs Public Sector Wage in Developed and Less Developed Countries

Data on developed countries (OECD) show that the real private wages throughout time have been higher than real public wages (Afonso & Gomez 49). Sweden, Norway and Canada, as highly developed countries are shown to have higher private sector salaries (see Fig.2.9). On the other end of the spectrum is Greece, which has maintained higher public wages throughout time (see Fig.2.9). This can be employed to argue that even though public sector in less developed countries is the main employer, it is characterized by inefficiency and ineffectiveness. And this is mainly because developing countries face difficulties in building a coherent public sector salary system that could be the corner stone of a motivated and effective public sector.

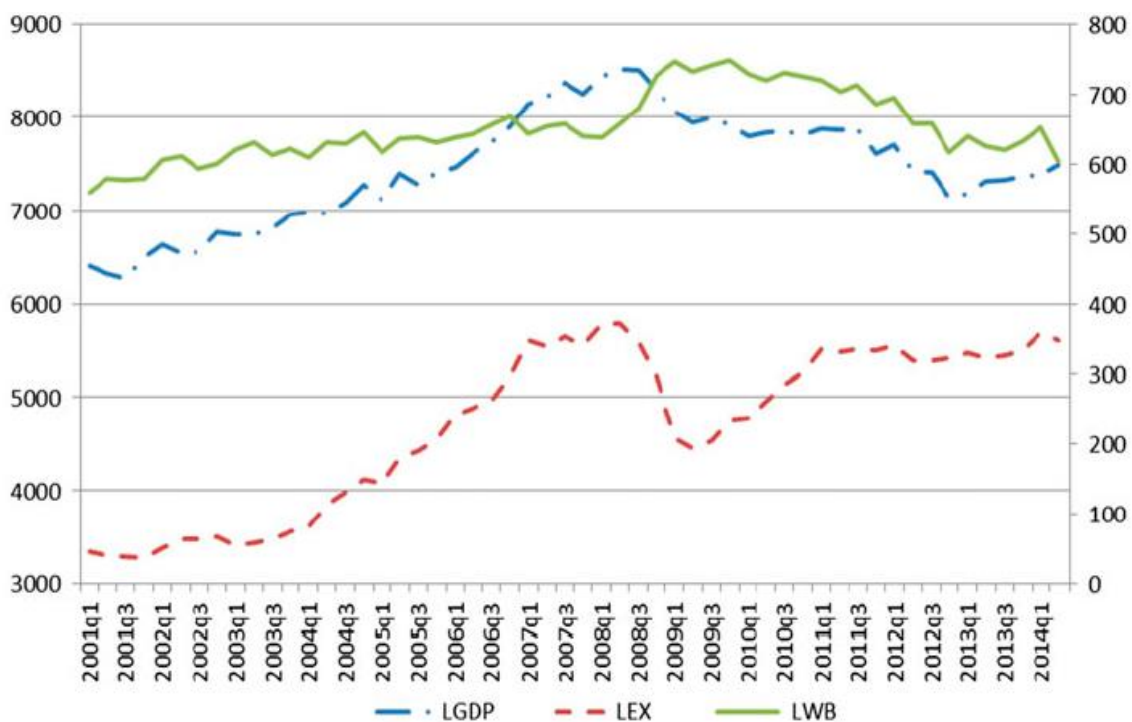
Figure.2.9. Public VS Private Wages



Source: http://ssrn.com/abstract_id=1302785

The disproportionate rise of public wages may induce spill-over effects on wages of private sector, and in so doing create imbalances of the economy since the labor costs of the country have diverged from the global competitors. Slovenia is an example, with a public wage bill that accounts for one fifth of the public expenditure (Ministry of Finance, 2014). The example of Slovenia is of special interest because it portrays the consequences of having increases in public sector wages that are not followed by proportionate increases of GDP. Slovenia was viewed as the most successful transitional economy from the former Yugoslavia, where it has shown growth and stability over the years. By doing so it was capable of entering close economic relationships with EU countries (Mirkovic 5). However, Figure.2.10 portrays the economic situation in Slovenia where the relatively high amount of public wage bill spending has increased faster than the GDP, and that is when GDP and exports started to decline, thus leading to economic crisis. Slovenia has been facing issues due to the fact that the public debt has increased over time, while public sector unions have strongly resisted the reduction of public wages.

Figure.2.10. GDP, Export of goods and services and public wage bill spending in Slovenia



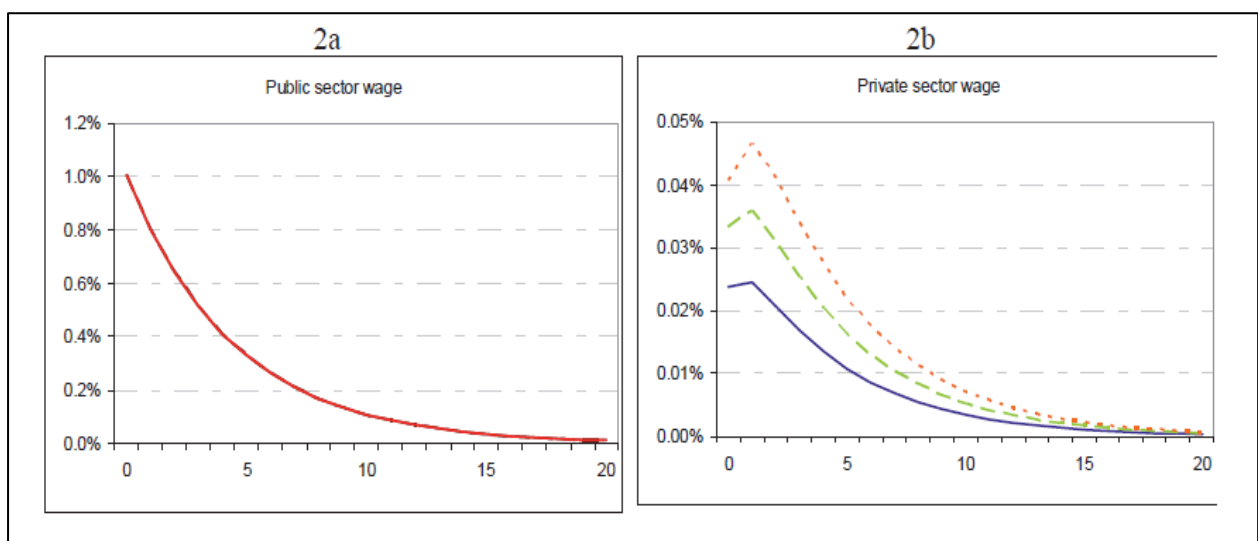
Source: <http://www.tandfonline.com/action/journalInformation?journalCode=rero20>

The impact of Public Sector Wages on Private Sector Wages

Studies on the interaction between public and private sector wages support the idea that public sector wages positively impact the growth of private sector wages (Alfonso & Gomez 3). It is argued that wages of workers on the public sector excrete influence on the private sector wages by increasing the value of being employed in the public sector due to the wage that it provides; thus, higher amount of pressure is put on the wage bargaining. Additionally, since the public wages and employment are financed through the revenues generated by taxes, this will reduce the overall profit and as such increase the difficulty of remaining part of the market.

Therefore, the model presented in the working paper explains the relationship between public and private sector wages, and it is shown that as public sector wages increase by 1%, this triggers a 0.1% increase in private sector wage. In addition, an increase in public employment is followed by 0.45% increase in the private sector wages (Afonso & Gomez 32). Consequently, such findings should have crucial role on policy implementation; thus, providing evidence that the government is to place special focus on the wages it sets if it is to focus on economic growth and stability.

Figure.2.11. The response of a 1% increase in public sector wages



Source: <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp971.pdf?8f9d6a8ad5e9012e61231badcea948b2>

III. Literature Review: Kosovo

The after war Kosovo was left with no functioning institutions, which would have to be built from the beginning with the assistance provided by the international community. The resolution 1244 presented by UN Security Council attributed to UNMIK the responsibility of creating and controlling the civil administration in Kosovo. UNMIK aimed the implementation of its duties through a considerably strong collaboration with existing political representatives in Kosovo. Therefore, UNMIK started executing this responsibility by creating the staff for local and central government (Marcus 4). In 1999 an Agreement on a Joint Interim Administrative Structure was formed between UNMIK and political parties, where 20 departments were established. These departments played the role of the ministries, but the decision making remained a responsibility of internationals. The first municipal elections were held in 2000; consequently, the municipal level of administration was drastically affected. The UNMIK Municipal Administrators had the authority over decision making, and the transfer of administrative powers to the municipality began only when the local structures were shown to have built the capacity to be effective and capable of implementing their duties (Marcus 4).

Meanwhile the international status of Kosovo remained unsolved, but there was a necessity for Kosovo to develop institutions based on legality and a system of checks and balances and a separation of powers. In 2002 the Provisional institutions of Self Government were established and as such the authority and responsibilities started to shift to these institutions (Marcus 7). Healthcare and education sectors started functioning and workers that were employed there before the war returned to their jobs. On the other hand KFOR was assigned the duty of providing protection for the society in Kosovo and simultaneously provide security for the return of Serbs. KFOR and UNMIK Police exercised the duties of the police and army in Kosovo, while in 2000 Kosovo Police started implementing their responsibilities with around 800 members (Marcus 11).

Legislation

Various laws and regulations are currently established that seek to regulate the employment in the public sector. The laws governing the public sector in Kosovo:

- Law on Budget of Republic of Kosovo for Year 2016
- The Law on Labor
- The law on the Civil Service
- The law on Salaries of Civil Servants

Law on Budget of Republic of Kosovo for Year 2016

The law on Budget of Republic of Kosovo sets limitations on various institutions in the public sector that are funded by the Kosovo's budget. Employment and the compensations that are to be provided have to comply with the budget specified on the law on budget.

The law on Labor

The law on labor aims regulating the rights and responsibilities of employers and employees in both private and public sector in Kosovo. The provisions of the law are applicable to all employees that are employed within territory of Republic of Kosovo, regardless of their citizenship.

The law on the Civil Service of Republic of Kosovo

The provisions of the law aim to set the status of Civil Servants and their relationship with the central and municipal administrations. Such provisions apply to the following institutions: the administration of assembly, the administration of the office of the president, the office of the prime minister and ministries, executive agencies, independent and regulatory agencies and municipal administrations.

The law on the civil service states the categories of workers in the public sector that are excluded from the civil service.

“Under the terms of this Law the status of Civil Servant does not apply to the following categories: the teaching staff of the education system, the medical staff of the health service, creators and art performers, Police Officers of the Kosovo Police, Customs Officers of the Kosovo Customs, Correctional Officers of the Kosovo Correctional Service and Members of the Kosovo Security Force, political appointees and all the persons appointed in positions by the political appointees and members of their cabinets, starting from the cabinet of the President, President of the Assembly, Prime-Minister and cabinets of the Ministers. Their employment

relationship shall be regulated in accordance with the Law on Labor, special laws, collective agreements or with sector regulations” (Law on Budget).

Law on Salaries of Civil Servants

This law establishes a system and structures of salaries and allowances for Civil Servants, where the financial resources for such compensations are provided from the Budget of the Republic of Kosovo. The law also ensures the guaranteed equal payment for the workers that have performed jobs with the same value. The salaries are composed of the basic salary and allowances; the basic salary being the result of the value of the work, as well as the increases of salaries due to increased work experience.

The determinants of salary classification according to article 6.8 are:

- Responsibility
- Complexity
- Interpersonal communication skills
- Available qualifications and
- Conditions at work

Public Sector in Kosovo

In terms of population, Kosovo is considered to have a large number of public sector institutions, and thus number of employees. With the purpose of portraying the size and importance of the public sector in Kosovo, a special focus is placed on analysis of the budget of the Republic of Kosovo and its resource allocations in various expenditure categories; the analysis of wages and salaries are of crucial interest for this project. Based on the Law on the Budget of Kosovo for 2016, 82,773 employees are paid out of government’s budget. Since the establishment of the Provisional Institutions of Self-Government in Kosovo, there have been increases in the number of ministries, and so far despite promises, Kosovo has failed to decrease neither the number of ministries nor the number of public sector employees; thus it has increased the burden on Kosovo’s citizens

on paying the salaries for the employees of these ministries. Referring to the law on the budget for 2016, an amount of €548,231,558 has been allocated for wages and salaries, namely 34% of the total budget. The total amount dedicated to wages and salaries in the central budget organizations is 24%, while the budget allocated for the salaries of the staff of municipalities is 58% of the total budget. Table 3.1 includes the budget allocated for wages and salaries in the central and municipal level.

Table.3.1. Budget Allocation in Wages and Salaries and Staff size 2014

Budget Allocation in 2016			
	Staff	Salaries	Total Budget
Central Government	38,523	293,355,309	1,244,723,700
Budget Organizations dedicated revenue	418	6,443,857	11,775,168
Municipalities	43,832	248,432,392	422,210,619
TOTAL	82,773	548,231,558	1,678,709,487

Source: Law on budget 2016

Kosovo has 38 municipalities, which together employ 43,832 workers. The total expenditures for municipalities amount to 422,210,619, and out of them 248,432,392€ are used for wages and salaries, namely 58.8% of the total budget. Table 3.2 presents a summary of the expenditures for each category, including wages and salaries.

Table.3.2. Municipal Expenditures per Category

Municipal Expenditures per Category		
Staff	43,832	

Wages and Salaries	248,432,392€	58.8%
Goods and Services	38,222,300€	9.1%
Utilities	9,797,595€	2.3%
Subsidies	8,667,743€	2.1%
Capital Outlays	117,090,589€	27.7%
TOTAL	422,210,619	100%

Source: Law on budget 2016

Even though international reports and national organizations have called for a decrease in the public sector size, such sector has constantly grown. The number of ministries, and thus the number of employees and the amount of the budget allocated for wages and salaries in the public institutions have increased through UNMIK regulations, or sometimes through Kosovo laws, and in some cases by Government decisions which have been mainly election inspired. Table.3.3 summarizes the staff number and budget allocation for wages and salaries for 2014, 2015 and 2016. The laws on budgets for the respective years indicate that the public sector size and budget allocations for salaries have increased throughout the years.

Table.3.3. Budget Allocation in Wages and Salaries and Staff size 2014, 2015, 2016

Budget Allocation in Wages and Salaries and Staff size 2014,2015,2016			
	2014	2015	2016
Staff	81,240	81,952	82,773

Wages and Salaries	487,160,730	560,066,286	548,231,558
TOTAL	1,589,324,952	1,682,486,849	1,678,709,487

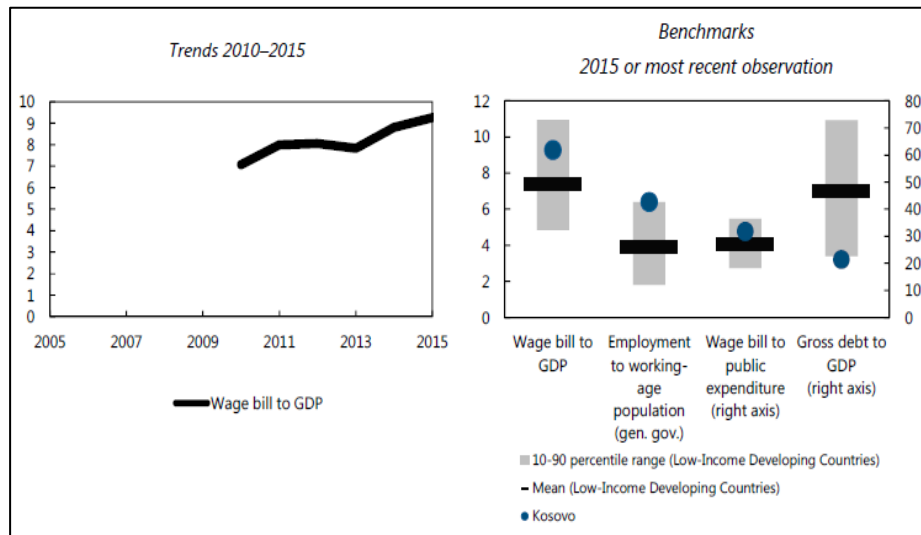
Source: Law on Budget

Public Wage Bill Increase in Kosovo

Since 2008, the public wage bill has grown almost three times faster than nominal GDP, and additional hiring in public sector increased the pressure on the government wages. Wage increases and government employment tend to occur before the elections, and this suggests that such wage changes are not based on long term plan of government. Therefore, the government wages are affecting private labor costs and competitiveness (IMF 44). Given that central and local government provide almost a quarter of all jobs in Kosovo, there is a considerably low employment in the private sector; thus, the participation rate in Kosovo is around 40% and approximately 30% of people actively looking for a job are unemployed (IMF 44). The public wage bill triggers cost spillovers to the private sector, where after the increase of public sector wages in 2011, average private wage grew by more than 10%, thus damaging the Kosovo's competitiveness (IMF 44). The average public sector wage is higher than the average private wage by more than 30%, therefore it is challenging for the private sector to retain competitive talent.

The increases of public wages are concerning because such increases usually occur before elections, and this has caused for the wage bill to increase more than the GDP ratio. Before the 2011 elections, there was a 50% base wage increase, thus leading to an increase of the total wage bill of approximately 27% (IMF 45). Without the approval of the parliament, before the 2014 election the public sector salaries increased again by 25%. Consequently, the public wage bill currently is considered to be high when compared to other low-income countries. Increasing hiring before the elections has also pushed up the wage bill, where between 2010 and 2014, 5,100 new workers were added to the staff of the central and local governments.

Figure.3.1. Wage Bill and Employment in Kosovo



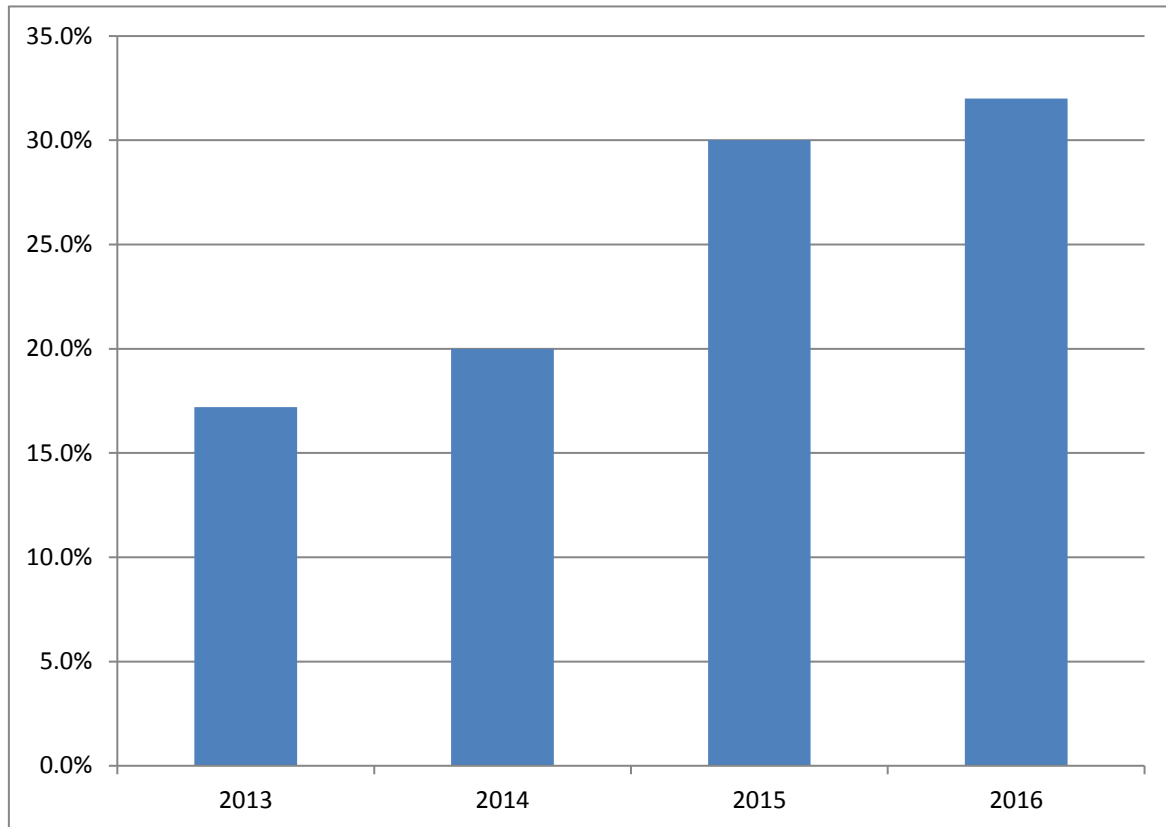
Source: IMF Staff Calculations

Salaries and Wages in the Education Sector in Kosovo

Human capital is the main factor of production of a country, and public spending in education tends to increase with the expectations that such investment will trigger economic development. Based on the existing literature, 38% of Kosovo’s population is under 19 years old; thus making human capital Kosovo’s greatest asset. Indeed, education is considered to play a crucial role in creating the preconditions for economic growth, and investments on this sector are regarded as essential components that contribute to development. Employees of the education sector in Kosovo have encountered wage increases over the years. Data show that from 2007 until 2013 salaries for teachers have increased regularly, where for these 6 years salaries for university professors have increased by 100%, yet international reports and organizations portray a reality where education level has not improved (Xharra & Blakaj par.6).

The law on budget for 2013,2014, 2015 and 2016 is utilized to summarize the increase in the allocation of the budget for the ministry of education, where some of the budget is utilized for the salary increases. The expenditures of the ministry of education for wages and salaries as a% of total expenditures have increased over the years.

Table.3.4 Ministry of education: Wages and Salaries as a percentage of Total Expenditure 2013-2016



Source: Law on Budget 2013-2016

Salary increases do not necessarily directly influence the effort on a job, however, there are certain models that aim showing that the worker effort is indirectly improved in response to pay increases. Increasing the compensation for public workers in pro-social tasks like teaching, reduces the desire to put energy on outside jobs, and instead increase the time and effort on their current job as teachers (UNESCO 2014). It is reasonable for teachers who spend their nights and weekends working on several jobs, to not be capable of devoting the necessary attention to students in class. Thus, higher salaries in the education sector influence the reduction in the absenteeism rate, given that teachers do not get involved in private tuition to be capable of meeting their financial needs (World Bank 2010). Additionally, literature suggests that when teachers’ monthly payment is lower

compared to salaries in the region, their moral and time available for teaching will be reduced. Thus, it is argued that: “low pay is likely to be one of the main reasons why teachers perform poorly, have low morale and tend to be poorly qualified” (World Bank 2008). Finally, reports on the issue seem to suggest that salary increases are a means to attracting talented teachers in the public sector that can contribute substantially to the human capital of a country.

Private Sector in Kosovo

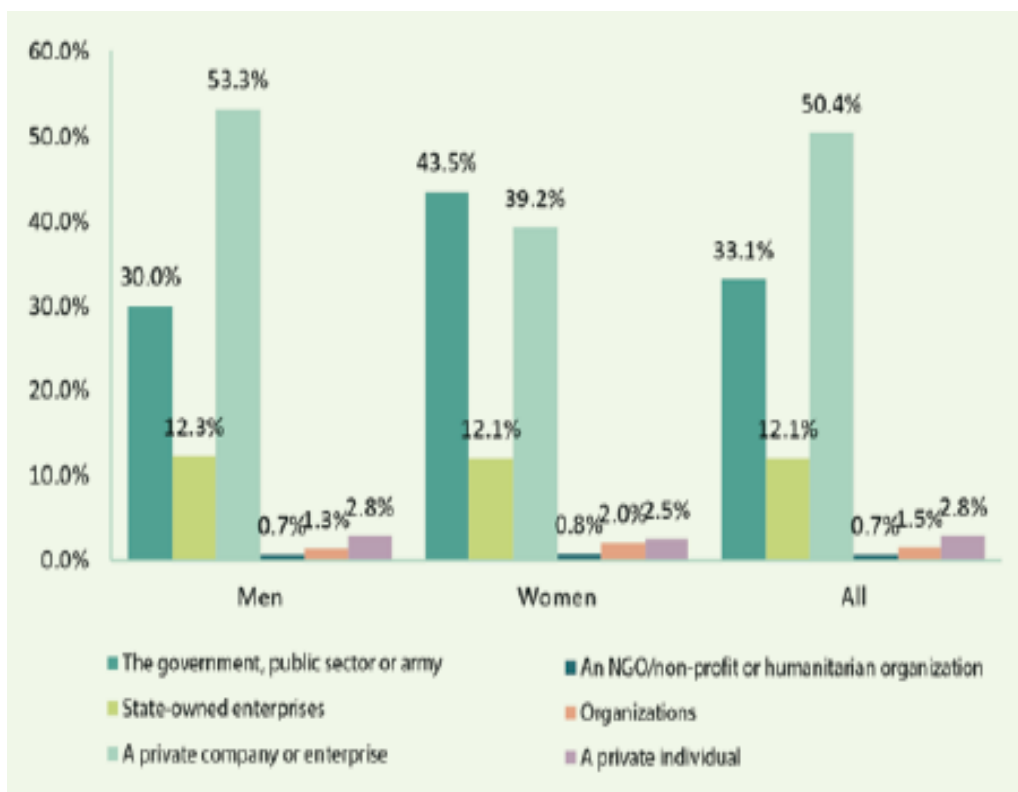
The development of private sector can play a crucial role especially in fragile and conflict-affected states. It is argued that private sector can positively affect the prevention of conflict and in so doing contribute to peace-building (Peschka 3). Therefore, such sector requires special policies and instruments, especially in states like Kosovo that were heavily affected by war (Peschka 4).

While after war Kosovo's economy has been mainly built on international donor assistance, remittances from diaspora and public sector expenditures, the role of the private sector and especially of SMEs has been relatively weak. Our country seems to suffer from a negative payment balance, as imports significantly dominate the exports, as this is mainly a result of Kosovo's SME lack of competitiveness on the local as well as international market (Kosovo Human Development Report 2016). The overall unfavorable environment to business has resulted due to the combination of particular internal and external factors, where the research on 800 micro, small and medium enterprises in 2010/2011 show that the main obstacles to SME development are: access to finance, electric energy, and the lack of government support through tax breaks and various incentives (Ministry of Trade and Industry). Kosovo as the least-developed country in South-Eastern Europe strives to catch up with its neighboring countries, yet if comparisons are made with regional countries it is easy to notice the lack of support from government towards SMEs. For instance, the government of Macedonia stimulates investments by financing 50% of the investment, and simultaneously provides tax breaks up to 10 years (Ministry of Trade and Industry). Similarly in Serbia, up to 10,000 EUR are offered for work being created in less developed cities (MTI).

Furthermore, despite the improvements in the legal and policy framework for ease in doing business in Kosovo, where it has moved from 86th position in 2014 to the 66th in 2016, private sector has not yet shown significant increases in demand for labor (Kosovo Human Development Report 2016). The domestic private sector in Kosovo remains underdeveloped and dominated by family owned firms that mainly trade imported goods. Additionally, the 2014 KOSME (Kosovo Program For the overall Small and Medium Enterprise Promotion) report shows that 56% of the registered enterprises in Kosovo employ only one person (Kosovo Human Development Report 2016). Thus, the lack of investment in large scale

industries is keeping the low demand for labor in the private sector. Countless issues characterize the private sector, and such issues seem to penalize women more than men. Reports show that more than half of the employed women, namely 56.6%, compared to 42.3% of men work in the public sector, while about 39% of women compared to 53% of men work in private sector (see figure 3.2). This may be explained by the preference of women to work in the public sector due to higher job security and social protection benefits. The reports on maternity leave in Kosovo show that the provision of maternity leave impact negatively the process of hiring women in private sector.

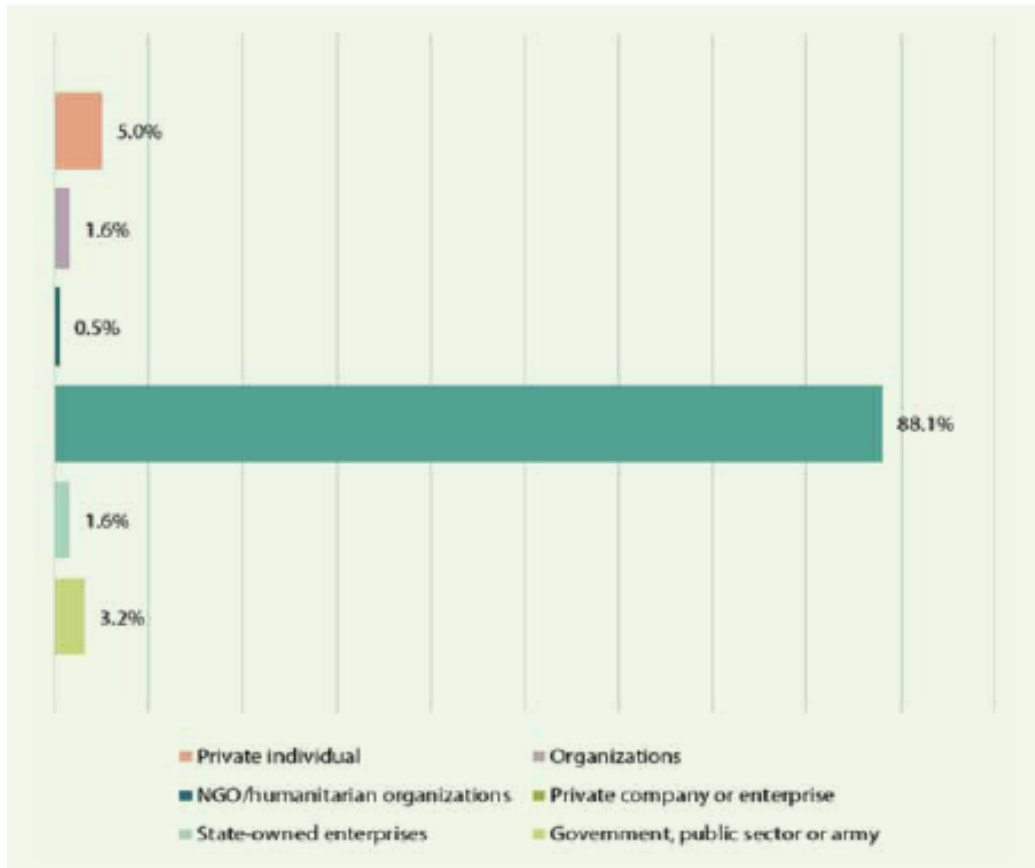
Figure.3.2 Employment by gender and sector



Source: Kosovo Human Development Report 2016

Even though the public sector is the main employer in Kosovo, the private sector is the main employer of young women and men in Kosovo, thus employing more than 88% of youth. On the other hand, the public sector and state-owned enterprises employ less than 5% of young women and men. This is illustrated in figure 3.3.

Figure.3.3. Employment of youth by sectors



Source: Kosovo Human Development Report 2016

The gap between the public-private salary plays an important role for the economy as a whole. The right salary gap between the two sectors can motivate the private sector to develop and perform better. However, salaries in the public sector in Kosovo have increased rapidly compared to the salaries in the private sector, and this may demotivate individuals to find a job in the private sector as they consider the public sector to be a more secure environment that offers faster growing salaries (Morina 12). Nonetheless, the growth and development of the private sector is an important catalyst for the overall growth, especially in developing countries. Thus, the public sector is to play attention to the salaries it sets, so that it does not demotivate successful people from entering the private sector and developing it. The table 3.5 shows the data provided by KAS regarding the average number of hours worked in public sector (36 hours a week) and private sector (48 hours a week). Lower number of hours worked is another factor that encourages people

to work for the public sector (Labor Force Survey 2015). This also shows that despite the fact that private sector workers work for more hours, they still get lower salaries where the average monthly salary is around €354 thus, this can be considered as a rough indicator of our reality.

Table.3.5.The average number of hours worked by employer

Kosovo 2015	Gov, public sector	State Owned Enterprise	Private Company
Gender			
Male	37 hours	39 hours	48 hours
Female	35 hours	36 hours	45 hours
All	36 hours	39 hours	48 hours

IV. Methodology

The main objective of this project was to present analysis of the current situation of public sector in terms of wages, identify the outcomes for the private sector if the same trend continues, and suggest certain recommendations as to how the private sector should be the main employer and carry the responsibility to promote Kosovo's economy. The path towards achieving the main goals of the project consisted of analysis of budget allocations in public sector, analysis of the situations that led to the public wage bill increases, and analysis of the current state of private sector.

Considering the nature of the problem, this research/study followed a combination of quantitative and qualitative research approach. Therefore, the main source were the analysis of various documents and data provided regarding the budget and salaries, where Law on Budget for 2013,2014,2015 and 2016 were analyzed to compare the trend of the budget allocation for wages and salaries throughout the years. In addition to that, scholarly books/articles as well as reports by international organizations have been employed to construct the project.

With the purpose of getting insights of personal views of people concerned with this topic, 6 interviews were conducted. One of these interviews failed to provide any relevant or important information, either because the interviewer did not provide specific enough questions, or the interviewee was not willing to offer the information that was required to provide. Thus, only the results of 5 interviews are included in this project. These interviews were semi structured and aimed to provide a clearer picture on the issue, and as such representatives in the public sector, private sector and labor union were selected to present their views and opinions regarding the salaries in both sections, and how this affects the economy as a whole in Kosovo. An important goal of this project was to see whether there have been changes in the level of performance or productivity in the public sector after the wage increase, with special emphasis on the education sector. Thus, X High School was used as a case study, where interviews with the representatives of the school, as well as data and documents provided by them were utilized to show that it is questionable whether wage increases have resulted in performance improvements in X High School. Because of the anonymity principle, the names of the individuals interviewed are not to be revealed,

but the institutions they come from are made public to get an understanding of the relevance and competence of the person to the issue discussed. The questions asked to the interviewees were formulated based on the secondary research that was conducted prior to the interview. The questions aimed to get information that was unreachable otherwise, as well as clarify potential ambiguities that I was facing while searching for the topic. The questions of the interviews are presented under the Appendix Section, namely appendix 3. Given that interviews were conducted to collect information mainly regarding employers' perspective in private sector, the perspective of employees as well was considered as highly important to building the arguments of this project. Therefore, a survey was conducted to reach private sector employees, where the responses received reached to 63. The respondents were asked 14 questions (see appendix 1) and results are better explained in the outcome analysis. This questionnaire was intended to collect information from private sector workers; however, questions regarding age, gender and education were asked before the respondent claimed whether he/she works in the private or public sector. If the person was currently working in the public sector, he/she was required to stop filling to survey. This was done with the purpose of gaining more information regarding the demographics of public sector as well.

Steps followed to gain access to the subjects

The project's main objective was to construct and present a report on the issue on hand, but the information gathered were to be collected through an ethical and safe research while dealing with human subjects. Given the high importance of the qualitative research for this project, namely interviews, an online training course was taken. The Collaborative Institutional Training Initiative (CITI Program) is a training course that provides certain criteria that are to be fulfilled while conducting the research, with the aim of minimizing the risks to the subjects, as well as to ensure that the privacy and confidentiality of the subjects and the data are maintained. An adequate consent form was developed and handed to the interviewees so that they would get informed regarding the general objectives of the interview. The purpose of the study, the duration of the interview, the number of the questions that the interviewees will have to answer, as well as the

statement of confidentiality were part of the consent form. The interviewees were required to sign this consent form as to show that they have voluntarily accepted to participate in this research by taking part in the interview. The consent form is presented under appendix 2.

Secondary Sources

As mentioned above, the analyses of the secondary data regarding salaries in the public sector, as well as private sector are of crucial importance for the achievement of the projects' objectives. Secondary data was collected from the Ministry of Public Administration, where the data were analyzed with a special focus on the wages and salaries of the institutions in the central level. The law on budget for the 2013, 2014, 2015 and 2016 were analyzed to notice how expenditures have changed from year to year, and to see whether there has been some trend or pattern in terms of increases in the expenditures for wages and salaries. In addition, reports of the World Bank, USAID, and the Kosovo Statistics Agency were employed to construct this project.

Interviews

1. Representative from X High School:

The main purpose of this interview was to get informed regarding the performance of teachers in this high school, and how the changes in salaries throughout years have influenced the teaching process. The interview was recorded after the interviewee agreed to do so. The main points of the interview were the performance of teachers and the methods utilized to measure such performance, the results of Matura exam throughout years, the average salary of teachers, and the potential relationship between the linear increases in salaries and productivity of the teachers. The interview took place on November 2016.

2. Representative of X Company- Private company with around 2300 workers:

The main purpose of this interview was to get the perspective of a person who has worked for the public sector and currently is working in the private sector, and simultaneously get informed about the main impact in the private sector caused by the current public wage bill. The interview was recorded with the approval of the interviewee. The main points discussed were the potential pressure placed on the private sector to increase wages due to public sector wages, the lack of skilled workers for private sector (especially for X Company), and the loss of workers due to public sector wages. The interview took place on December 2016.

3. Representative of the Union of the Independent Trade Unions of Kosovo:

The main aim of the interview was to get the perspective of the union on the public wage increases. The interviewee was asked whether the interview could be recorded, but the interviewee did not agree; as such only notes were taken during the interview. The main points discussed during the interview where the impact of the union on public wage increases, the reasons behind the pressure made by the union to increase wages in the public sector, and potential future plans regarding the private sector wages.

4. Representative of the American Chamber of Commerce in Kosovo:

The representative of AmCham as an association of business people was utilized for the purpose of collecting more information regarding the private sector in Kosovo, as information for this sector are much harder to obtain. The interview was conducted through email since it was almost impossible to find a suitable time for the interview to be conducted face to face. The answers provided from this interview were not very concrete and not as informative as desired, as either the questions were not specific enough, or the interviewee was constrained due to busy schedule. However, the interview was helpful as it provided certain information that I could not find otherwise. The interview was conducted on December 2016.

5. Representative of Y Company:

The interview was conducted face to face and it was recorded with the approval of the interviewee. The representative of Y Company was interviewed with the purpose of collecting information about the effects of increases in the public wage bill. The results of this interview were important as they were to be compared with the results obtained by the representative of X Company, as to observe whether these two companies are

dealing with similar issues. The interview helped to further build arguments on the implications of public wage increases in the private sector. The interview was conducted on November 2016.

Limitations to the methodology

Certain limitations faced during this project contribute to potential bias as well as increase the difficulties of portraying a clearer view of the situation in terms of the discussed topic in Kosovo. The lack of secondary data, including here publications related to salaries and potential effect on the private sector that could have been used to enrich this project is one of the limitations faced. The lack of statistical evidences further complicated the process of collecting data that would support the project. Another limitation is the failure to obtain data for the salaries of certain institutions and private companies since they were reluctant to provide such information.

The interviews conducted may not be enough to portray the big picture and as such show all the implications of the public wage bill increases for private sector. Furthermore, one interview was conducted via email and this certainly is a limitation, since if the interview would be conducted face-to-face there is a higher probability that the information gathered would be richer in terms of content, the interviewee could have been interrupted when giving information that is not relevant to the issue, and as such the interview as a whole could have been better instructed. Also, the interview conducted in the high school regarding the teacher's performance may include bias since the representative of the school was trying to overestimate the performance of the school as a whole. Even though people interviewed for this project come from big staff institutions in the public sector and large businesses in the private one, they cannot be used to illustrate the characteristics of the entire public and private sector. Consequently, the limitations caused by the external factors indicate that the institutions subject to analysis were not representative of the whole public and private sector. On the other hand, language appeared to be a barrier during the surveys, since some respondents were not Albanian speakers, and as such needed translation to understand the questions.

Indeed, the interviews and survey conducted were the cornerstone based on which this project was constructed and arguments were built upon; nonetheless, the project is limited on its conclusions, since there is a probability of potential bias given the timeframe when the research took place, financial constraints, possible respondent bias and/or other factors.

V. Outcomes and Analysis

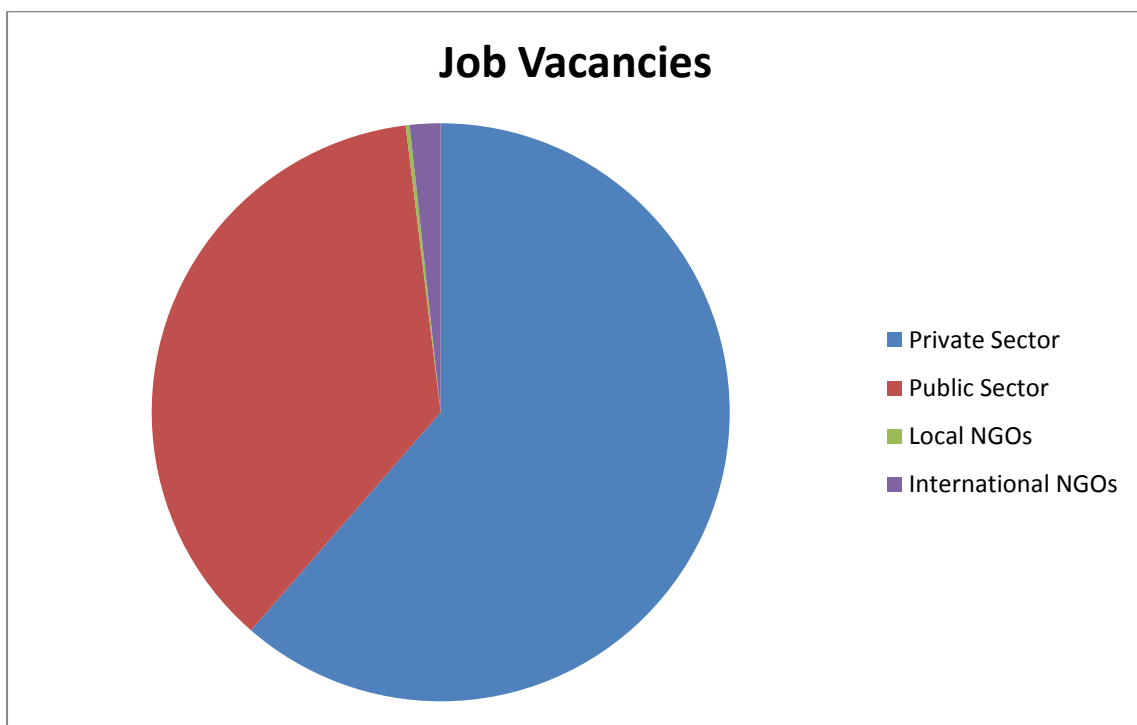
Throughout years the public wage bill in Kosovo has increased faster than nominal GDP. However, such wage increase has been mainly election inspired, has not occurred as a response to productivity improvement, and has impacted the activity of the private sector. The existing literature suggests that public share of employment and the salaries that governments set influence economic outcomes, and as such impact private sector. Therefore, the aim of the project was to provide information regarding the effectiveness of wage improvements in public sector, with a focus on the education sector, as well as identify implications of the public wage increases for private sector in Kosovo.

Government's higher remuneration to its employee's compared to the private sector, may lead to the absorption of talented workers, and consequently the private sector employment can be crowded out. Higher taxes, higher budget deficits or diversion of public recourses from productive uses could be some of the many outcomes of the public-private sector wage gap. Depalo states: "The public sector wage setting can have an important effect on labor market efficiency and macroeconomic outcomes" (5). Thus, considering that the public sector salary in Kosovo has tripled in nominal terms and has grown three times faster than nominal GDP, it is important to identify the effects on private sector, as the sector that holds the responsibility for promoting growth.

The wage gap in favor of public sector is considered to be unjustified in terms of productivity considerations. Findings of Public Pulse Survey 2015 suggest that public employment in Kosovo is based on family connections, political influences or bribes. Only 15% of respondents have shown to believe that employment in public sector in Kosovo is based on education or professional experience. Consequently, the theoretical expectations that higher wages in public sector are justified by the academic achievements of employees may not necessarily hold. As a result, high skilled workers may end up in private sector despite the wage gap in favor of public sector, as well as they may find themselves working in low skilled jobs given that they are not offered the opportunity to work in public sector due to nepotism. In addition, the salaries in private sector may be underestimated due to large scale of informality (Public Pulse Survey 2015).

The research shows that private sector appears to have higher number of job vacancies when compared to public sector; thus consisting of 61% job vacancies, while public sector 37% (Kolegji Universum). The high number of job vacancies in private sector could be explained by the difficulties of private companies to recruit workers because of the high competition with the public one, since job seekers in Kosovo tend to focus on the public sector due to higher wages and benefits offered. Local and International NGOs have shown to have had 10 and 77 job vacancies respectively.

Figure.5.1. Job vacancies based on employer



Source: Kolegji Universum

Thus, analyses of existing literature suggest that there are certain issues encountered by private companies associated with a rising public sector wage bill. Kosovo, a country where the role of the private sector and especially of SMEs has been relatively weak is assumed to have been impacted by public sector employment and wages. Therefore, this project’s main arguments are that the rising public sector wage bill has resulted in:

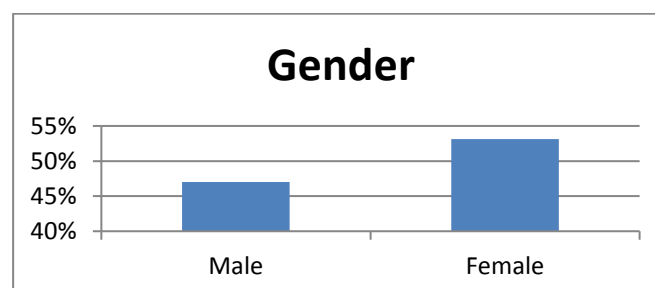
- Insufficient labor supply for firms
- Pressure on corporate employer to increase wages
- Higher employee turnover rate
- Crowding out private sector investment

The survey results and interview outcomes are to be utilized to show whether such arguments are supported by the findings.

Survey Results

As workers’ opinion is highly valuable for constructing the outcomes of this project, a survey was conducted (see appendix 1) to get the perspective of private sector workers on public vs private sector wage gap. The respondents were asked 14 questions regarding their preferences of working in public or private sector, the influence of increase of public wage bill in their willingness to switch to public sector etc. Survey responses received reached to 63, but 12 of the respondents worked currently in the public sector, and as such their responses were used only for demographic purposes. The results indicate that out of 12 people working in the public sector, 78% of them were females, and 52% of them were between the ages of 31-40. Thus, the outcomes of the survey reflect the preference of females to work in the public sector given the higher job security. On the other side, in private sector the gender difference appeared to not be as significant, where 53% were females and 47% males (see fig 5.2).

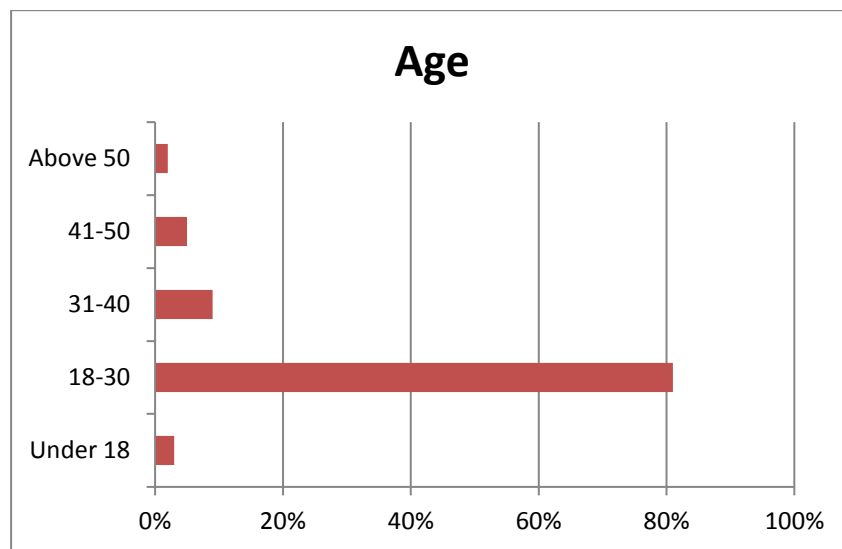
Figure.5.2. Gender of the survey respondents



The majority of responses was received by the private sector workers, namely 82% came from workers between the ages of 18-30. Nearly 9% were between 41-50 years of

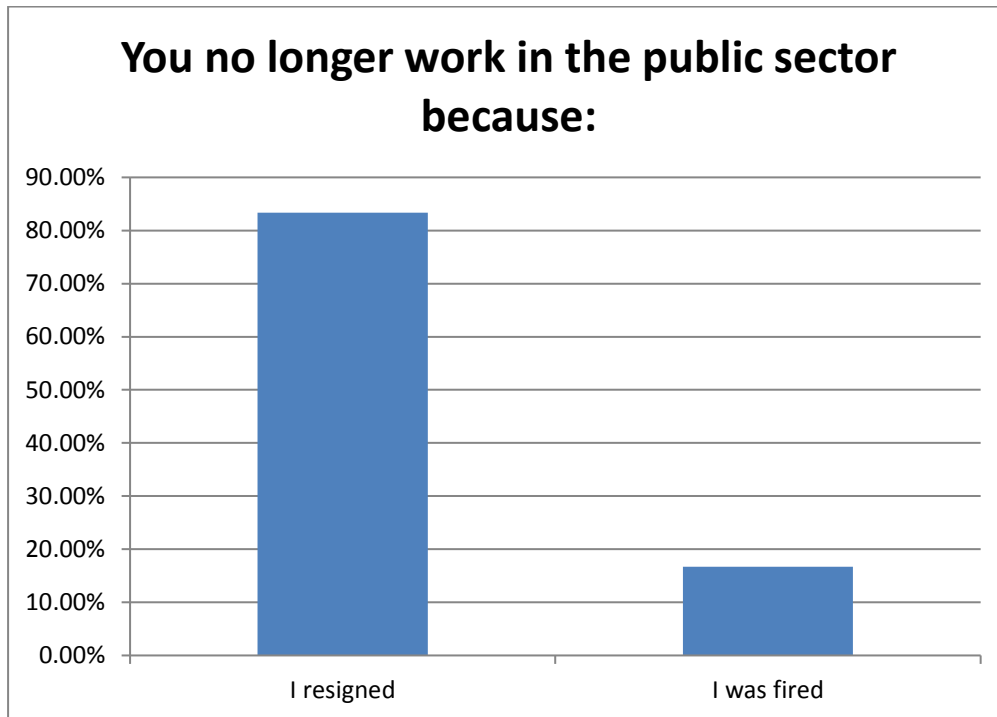
age, with no significant variations between genders (see fig 5.3). The high responsiveness from younger workers indicates that private sector holds higher interest for younger workers compared to senior employees, which are mainly part of the public sector, and as such are not necessarily concerned on the impact of public wage bill for private sector. This confirms the claims presented in the literature section, where it was shown that private sector in Kosovo employs higher number of young individuals compared to public sector.

Figure.5.3. The Age of Survey Respondents



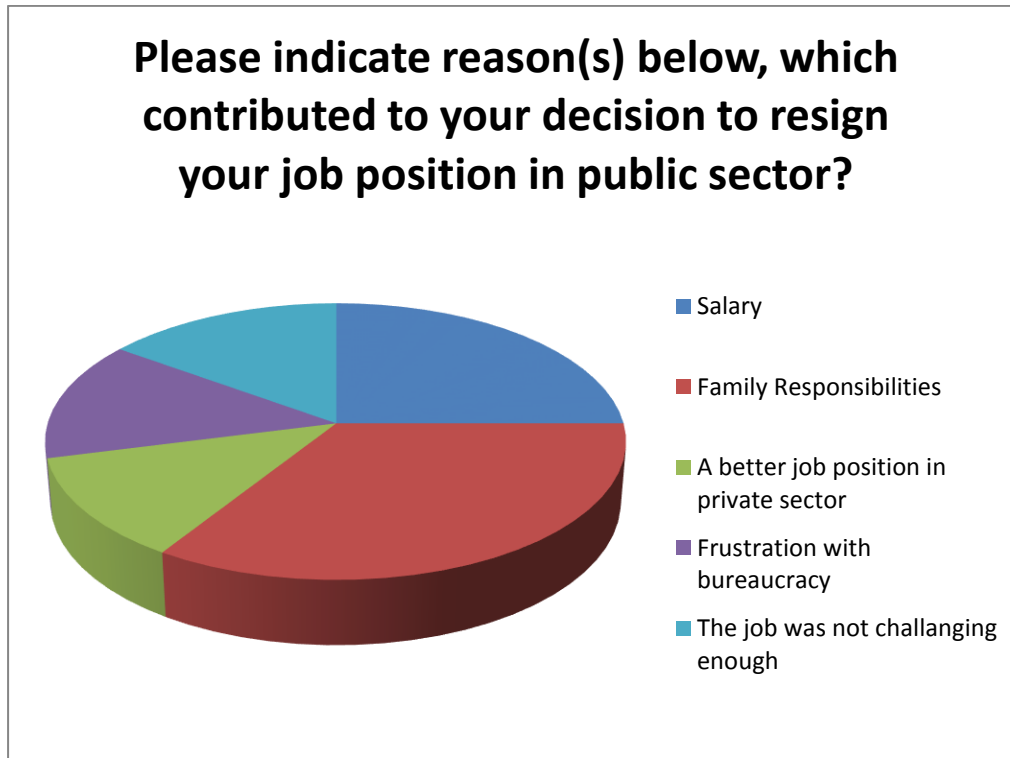
The workers were also required to provide information regarding their previous job, and whether such job has been in public sector. If the worker had previously worked in public sector, they were required to claim whether they were fired or resigned from that job position. Out of 51 respondents currently working in the private sector, 13 of them worked previously in the public sector, and 83.3% of them claimed to have resigned from this job position rather than being fired (see fig 5.4). This may be an indication of the higher job security in the public sector, but we acknowledge the potential bias in the responses received; thus, despite the fact that the responses were anonymous people usually tend to hide the fact that they were fired given that this may be indication of their inability to successfully complete the duties assigned.

Figure.5.4. Respondents reasons for no longer working in the public sector



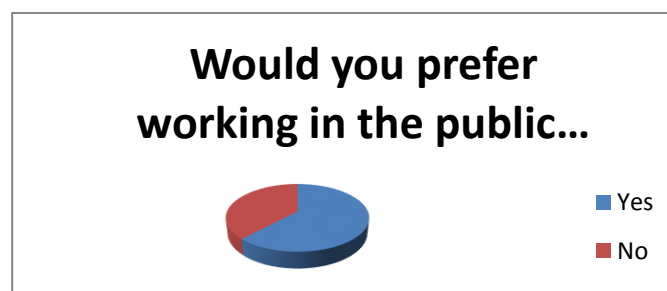
Among the reasons for quitting the job position in the public sector, “family responsibilities” was chosen the most, namely 34%. On the other side, a better job position in private sector was selected the least or approximately 12% of respondents chose this alternative (see fig 5.5). This may be utilized to portray the idea that private sector faces difficulties in attracting workers from public sector, as private sector appears to be less attractive due to the combined benefits offered by public sector. Even though salaries for certain job positions may be higher than in public sector, the benefits and job security influenced workers’ decisions to rarely give up their jobs for private sector.

Figure.5.5. Reasons for quitting the public sector jobs



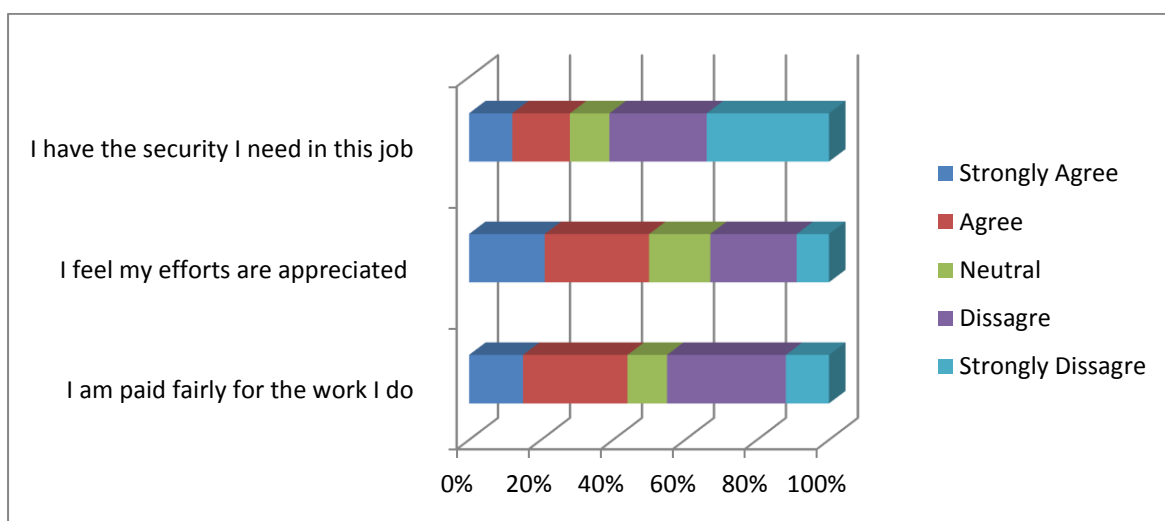
Furthermore, the survey results seem to support the opinion that is widely known in Kosovo: people favor public sector over the private one. 62% of respondents expressed preference to work in the public sector (Figure.5.6). This shows that the combination of several factors, including here the public wage bill, may lead to insufficient labor supply for private companies in Kosovo, and this is concerning having acknowledged the importance of this sector for the development of the economy.

Figure.5.6. The preference of respondents for public sector jobs



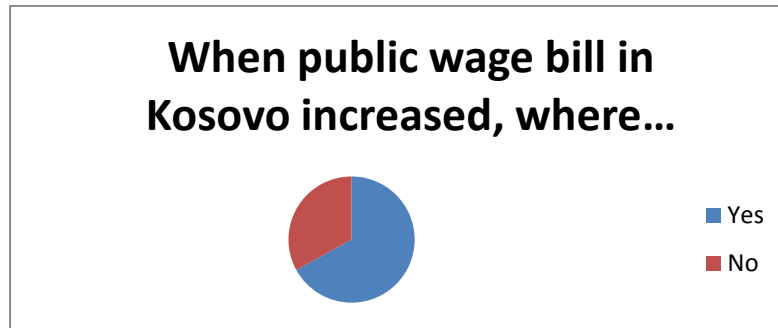
The workers were also provided with some statements (see fig 5.7) that they had to evaluate. Thus, 34% of respondents claimed that they strongly disagree with the statement “I have the security I need in this job,” 33% of them disagreed with the statement that they are fairly paid for the work they do, while less than third of them claimed that they feel that their efforts are appreciated.

Fig.5.7. Statements



Finally, given that one assumption of the project was that private companies have experienced employee turnover due to public wage increases, a question was asked to workers as to confirm that public sector wages affect their willingness to switch to public sector. Survey results show that 67% of respondents expressed their willingness to move to public sector when public wage bill increased.

Figure.5.8. The willingness of respondents to move to public sector



Therefore, the survey results indicate that a considerable number of workers in private sector were young, had university degrees, expressed preference for public sector, and were willing to switch to public sector when wages increased; thus, the survey outcomes were used as a foundation for formulating the interview questions for private sector representatives and as such were employed to analyze the outcomes of public wage bill increases in Kosovo. The employee turnover, the pressure to increase wages and lack of adequate skilled labor were the topics that were to be discussed with private companies' representatives.

Case: Company 1 and 2

X Company is considered to be one of the largest wholesalers in Kosovo and an exclusive distributor for well-known companies. This company is utilized to analyze the impact of public sector salary in its activity. The retail stores of the company are located in the main cities of Kosovo, workers are paid an average wage of €350, and work for 8 hours a day where extra hours started to be paid 6 months ago, namely since July 2016.

Table.5.1. Number of employees

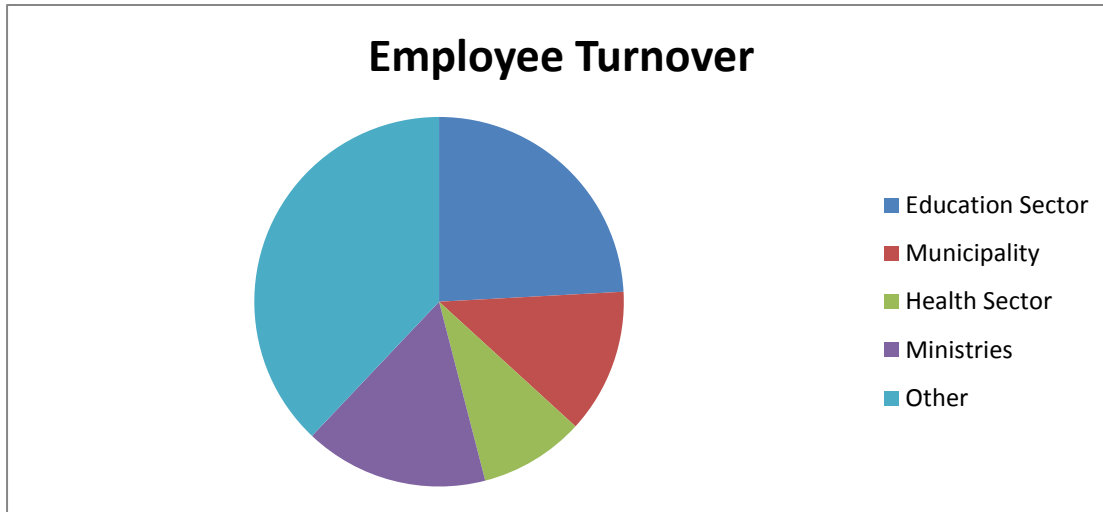
		Description
Number of Full time Employees	1886	Workers for the same position get different salaries, based on experience. Full time workers have health insurance, pension funds, free meals and after 5 years of work experience, they get 1 extra day off for each year of work.
Number of Part Time Employees	414	Cannot work for more than 120 days as part time workers. They get paid 10.60 Euro per day. Do not have health insurance, or pension funds.
Total	2300	

Source: X Company

A combination of higher wages, lower pressure in daily duties, higher benefits, and higher job security has influenced the complexity of competing with public sector. The representative of the company explained that these factors have influenced the pressure on the company to increase wages in order to keep the skilled workers that contribute in the performance of the company as a whole. Therefore, the public sector wage bill is one of the factors that have influenced the decision to increase the wage in this company. From 2017 the average wage in X Company is planned to increase to €500. The company plans to do so without changing or decreasing the current number of workers. The increase in salary is to be based on a plan that aims cutting costs of the company. Consequently, it aims to show that it is capable of competing with public sector, is to target skilled workers, and to provide better working conditions by managing the costs of the company. To illustrate the lack of attractiveness of private sector jobs, the representative of the company explained that when a retail store was launched in Deçan, only 2 people applied for a job position, even though the job requirements were quite common. This better reflects the wide belief of Kosovo's society regarding private sector: the private sector does not offer them the salaries, working conditions and the security they desire.

The decision to increase the monthly salaries has also been influenced by employee turnover. The pressure to increase salaries has been directly influenced by the number of workers that have left the company to work in the public sector. When taking into account the hiring and training costs of the workers, as well as the potential loss of skilled individuals that could have contributed to the company's performance, it can be concluded that X Company has encountered significant losses due to employee turnover. Only during 3 months of 2014, 17 workers had left the company to work in the public sector, where the majority of these workers were women, and had left the company to work as teachers in the education sector. The statistics provided by the company show that for the last 2 years they have lost workers mainly to public sector: 21 employees have left the company to work in the education sector, around 11 to work in different municipalities, 14 other to work in ministries, 8 in health sector, and 34 in other public institutions (see fig.5.9).

Figure.5.9. Employee Turnover



SOURCE: X Company

On the other hand, another company, coded as Y Company, was analyzed to show the effects of public wage bill increases. The representative of the company was required to provide information on the same issues discussed with representative of X Company, as to compare the results obtained from them. Y Company, as one of the largest private companies that operate in Kosovo shows that it faces similar obstacles as the ones mentioned by X Company’s representative. Y Company has currently employed many young individuals as interns and the majority of them were offered full time jobs. This company is seeking to replace the majority of former employees with younger workers, and the main reason behind this is that they are planning to offer them lower wages as they are new workers in the company, and in doing so they plan to avoid the high labor costs that they encounter. This comes as a confirmation to the claims provided in the literature section, where Damant & Jenkins suggested that: “existing jobs in the private sector require lower levels of education and tend to attract younger employees; thus affecting private sector pay”(5).

Further, concerning is the fact that many workers that have worked for Y Company for years have resigned from their jobs in the company to work in the public sector in the first

opportunity they were offered. The representative of Y Company claimed that this is the case especially with older workers as they prefer the security and stability that private sector does not necessarily offer. On the other side, hiring younger employees is justified provided that younger individuals seem to prefer challenges, the work in groups and are more flexible, characteristics that are desired in the private sector.

Consequently, all the outcomes that are indirectly induced by the public sector activity and salaries it offers, have increased the difficulties for private companies to generate profit and thus be competitive in the market, and in so doing contribute to the development of the economy as a whole. An increase in the wage bill creates imbalance between public and private employment, and there is the possibility of potential crowding out of private investment. Even though no one disputes over the importance of the Government in providing employment, the potential loss of investment and subsequent loss of economic activity may outweigh the benefits of lower unemployment triggered by public sector.

Union's Perspective

It is acknowledged that wage increases are permanent requests of labor unions that keep being presented to different governments. However, even though the union in Kosovo has requested wage increases, analysis show that they haven't really had a say in these public wage bill increases; rather, their requests have been utilized as justifications in the absence of real reasons and arguments for increasing the wage. The representative of the Union of Independent Trade Unions of Kosovo claimed that their requests have never been taken into account at the moment when requests were presented; instead, only after months passed and elections were announced, the government declared that by taking into account the requirements of the union has decided to contribute to the well-being of workers by increasing their monthly compensation.

The minimum wage in Kosovo, even though is not a primary concern of this project, is another factor that is considered as highly important for the labor demand in private sector. Based on the General Collective Agreement of Kosovo the minimum wage (currently €170) needs to be renegotiated. Such minimum wage is determined based on certain criteria, where one such criterion is the average wage. And this is where the biggest dilemma lies, to either

take the average wage of the public sector or the private one. However, despite the difficulties of deciding, the union seems to be confident that after the negotiations, there will be no minimum wage in neither public sector nor private one lower than €200. Even though the minimum wage is not addressed in this project, it is considered as another factor that Kosovo's government needs to play emphasis to due to possible outcomes, especially for private sector. In addition, referring to the General Collective Agreement of Kosovo, employees are to get 0.5% of the base salary for every additional year of experience. This means that even if the government does not increase wages, for every year the base salary will increase referring to this agreement. Consequently, the burden on the taxpayers of Kosovo will increase. Thus, the combination of higher minimum wages and higher taxes can significantly influence the performance of private companies, and directly impact their competitiveness in the local and international market.

The enforcement of laws is the main weakness of private companies that often fail to recognize the rights and duties towards workers in this sector. But, even more complex is the situation with international companies that operate in Kosovo, such as KEDS or Sharrcem, that often do not recognize the laws currently in force in Kosovo, and as such workers in these companies are subject to right violations. The survey results obtained from private sector workers and information collected from employers do not necessarily lead to the same conclusion. Employers tend to overestimate the working conditions and benefits offered to their workers, while survey results show that the majority of workers are strongly dissatisfied with benefits offered and in most cases are not even paid for working extra hours.

Thus, a private sector as in Kosovo that suffers from the lack of rule of law, difficulties in accessing sources of finance, lack of electricity, is further damaged by the unplanned public wage bill increases. The information offered by the labor union representative suggest that 38.46% of private sector employees work without a contract, and 81% of them claimed to work 50-60 hours a week, while only 9.82% are paid for their extra hours of work. In terms of vacations, 73.17% of private sector workers claim that they do not get paid vacations. Consequently, in addition to such disadvantages, a lower salary further contributes to reducing the attractiveness of private sector. Interviews seem to suggest that the request of labor unions to include meals for workers in the private sector has influenced the decision of employers to lower the number of workers and wages offered, and this seems to further damage and

discourage employment in this sector. Therefore, analyses imply that Kosovo faces difficulties in creating a favorable environment for private businesses, as economic policies fail to provide support for this sector. The whole relation between the state and private businesses ends with the collection of taxes.

Furthermore, even though there is a law that recognizes the right to strike and the right to form a union, there are certain cases where such rights are not fully respected and fulfilled. If private companies respect and encourage the formation of labor unions within the company, it would be much easier to contribute to the well-being of workers provided that these labor unions represent the workers. However, even though the failure of private companies to approve the existence of labor unions can be punished up to €30,000, cases of evident restrictions to the right to form unions are encountered. The identification of these irregularities in the private sector continues to be a challenge given the existing number of inspectors. Currently in Kosovo are around 68000 small and medium enterprises, and there are around 48 inspectors. Certainly, this is not enough and as a result the difficulty of identifying potential right violations increases.

Consequently, the outcomes of this paper seem to support the assumptions based on which the paper was constructed: The private sector in Kosovo competes rather than collaborates with public sector; consequently, a public sector with a faster rising public wage bill increases the difficulties for recruiting skilled workers for private sector, increases the pressure to increase wages, influences its competitiveness and directly affects the employee turnover.

As interviews and analysis suggest, wage increases in Kosovo have not been based on a long term plan. This is also confirmed by the failure of IMF to support public wage increases, because certainly IMF has noticed the lack of well-constructed arguments from Kosovo's side as why this wage increase is occurring and on what logical ground this is based upon. The outcomes appear to have important policy implications, as they suggest that government could use their role as an employer to plan the relative public sector wage increases, as doing otherwise, the tax burden necessary to finance government spending increases and private sector faces difficulties in remaining part of the market; thus affecting employment as a whole in Kosovo. The problems mentioned associated with private sector indicate that government in Kosovo need to create a balance on public and private sector wages and employment that serves rather than competes with private sector through infrastructure development.

Effectiveness of Wage Increases: X High School Case

Another aim of the project was to show whether wage increases in public sector have been associated with productivity improvement in education sector. The education system in Kosovo is characterized by high number of students in one classroom, low quality of studies, lack of equipment that facilitate the process of learning, and low monthly salaries for teachers compared to developed countries; however, wage increases have occurred systematically over the years. Such increases have at times been induced by the systematic requests of labor unions, but more often the salary changes have been election inspired, and have not been based on a long term plan. A high school in Peja, coded as X high school, with around 700 students and a staff of 97 people has been utilized as a subject to see whether the wage increases of teachers have resulted in performance improvement.

The wage increases, at least as has been mentioned by Kosovo’s governments, have been influenced by the belief that increasing teacher salaries improves their effort in classrooms and indirectly influences student’s academic achievements. Thus, the pay increases are widely viewed as the “cure” for the low quality in the education system by many policy makers (Chang 8). Nonetheless, despite the changes in wages of the public sector, there are no substantial improvements in the outcomes of the education sector in Kosovo. X High School comes as evidence that despite improvements in teachers’ compensation, there are no evident signs of improvements in teachers’ productivity.

The current base salary of teachers is €440, when to this base salary is added an amount regulated by the administration for the level of degree the teacher has, plus an additional amount for his/her years of experience(0.5% for each year of experience). From the documents provided, it was concluded that most teachers get more than €500 monthly.

Table.5.2. Teacher salary

Base salary (440 EUR)
+Degree

+Years of experience
-Pension
-Income Tax
Salary

Even though the X High School usually undertakes twice a year some means that seek to measure the performance of the teachers, there is high ambiguity whether performance has indeed improved. The means taken to measure the performance include:

- Self-evaluation of teachers 10%
- The evaluation of the director of the school 30%
- The involvement of inspectors during lectures 30%
- The evaluation of students and parents 30%

Nonetheless, the results often are very subjective and fail to trigger actions taken towards the teachers based on such results.

The representative of the school claimed: “Teachers are obliged to participate in various trainings offered mainly by the ministry of education, where such trainings aim to equip teachers with the necessary skills that would help the process of modernizing the education system.” Nonetheless, almost everything gained during these trainings remains in paper, since the lack of financial opportunities of schools and students restrict the carrying of activities that aim the enhancement of students’ skills. Sometimes parents even complained when students are required to do assignments that involve anything more than a pen and a notebook, since they lack the financial opportunities to provide their children with materials required for the projects. Thus, once again the efforts to enhance the performance of students, by improving the performance and engagement of teachers in classes appear to be merely futile.

Additionally, the wage increase has not been selective, but linear, meaning that all teachers regardless of their academic achievements or performance throughout years have encountered the same wage increase. This may motivate some, but simultaneously

demotivate others who consider that there is a discrepancy between the reward they deserve and the one they get; thus, the workers’ morals may be reduced whenever they consider that their contribution is higher than that of their colleagues but they are getting rewarded with the same compensation. Consequently, the students are served lower quality of teaching, and thus are punished even though their teachers are getting higher monthly salaries.

Furthermore, the Matura Exam, which is a standardized exam held in Kosovo after students finish their high school, can be used as a point of reference when discussing the performance of the teachers. Acknowledging the flaws of the exam and the idea that such exam does not necessarily measure what the student ought to know, the Matura exam results remain one of the ways of measuring the success of high schools around Kosovo.

Table.5.3. Passing rate in X high school in June 2015

	Natural Science	Social Science	Mathematical Science	Language	Minorities	Total
Total Number of students	308	177	67	42	16	610
The number of students that passed the exam	293	130	62	39	16	540
	95.12%	73.44%	92.53%	92.85%	100%	88.52%

Source: X High School

Table.5.3 shows that even though increases in the teachers’ pay are based on the belief that their performance is improved, such performance improvement is not reflected in the Matura Exam results, where such results for X High School got worse over the years. The results seem satisfactory, given that this school is usually ranked as one of the best high schools in Kosovo in terms of Matura Exam Results. However, the school has encountered a decline in the passing rates despite the salary increases of teachers. As such, in 2013, out

of 622 students, 590 of them passed the exam (94.8% passing rate) while in 2016, out of 614 students, 533 of them passed the exam (86.8% passing rate).

Figure.5.10. Number of Total Students vs. Students Who Passed the Matura Exam in June



Source: X High School

Even though the salaries of teachers have increased, and are considered to be higher than the teachers' salaries in the region, it is argued that it is still difficult for administrative supervisors to demand accountability for performance, since the salaries in the eyes of teachers are still not high enough. Consequently, the director cannot require teachers to work harder, give up their other jobs, and thus spend more time in planning their activities in the school. Further, the number of teaching hours (20 hours a week) has not increased after the wage increases, and data on the attendance of the teachers provided by the school management do not suggest any substantial improvement.

In sum, , the school management could not offer any evidence that the student test scores in language, mathematics or science have improved given the wage increases of teachers. Therefore, even though wage increases usually are based on the belief that the response to wage increase will be performance improvement, this is not necessarily the case in Kosovo. This is also reflected in the latest report of PISA, where Kosovo's education system was ranked amongst the worst in the world (the 68th country out of 72 states in total).

As a result, as in many developing countries, even in Kosovo, wages of public sector workers are typically not correlated with productivity. Consequently, increasing wages may not be a very efficient use of scarce public funds if the aim is to improve the quality of public service delivery.

VI. Recommendations and Conclusion

The focus of this project was to evaluate the implications of public wage bill increases for private sector in Kosovo. Its aim was to analyze how wage increases in the public sector have influenced the activity of private sector as the one sector that is considered to hold the responsibility for promoting growth and development; as such, the labor supply, employee turnover and the pressure to increase private sector wages were offered special emphasis. Another aim of this project was to show if public wage increases led to improvements in service delivery. This topic is important for Kosovo since the public sector is the main employer, and as in other countries its activity is directly financed by private sector development. Thus, due to its increase in size and wage, important implications are to be identified for private sector.

Considering the nature of the problem, this research/study followed a combination of quantitative and qualitative research approach. Thus, the analysis of existing data regarding wages and salaries for institutions in the public sector was conducted. Given that certain information was difficult to obtain, 5 interviews were conducted to get insights of people concerned with the issue discussed. The interviews included representatives of public and private sector in Kosovo. In addition, to include the views of private sector workers, a survey was conducted, where the results obtained helped to further build the arguments of this project.

The analysis suggests that the budget allocation for wages and salaries, and size of staff has increased over the years. The Education sector was of special interest since it was utilized to show whether wage increases have resulted in performance improvements. The budget allocation for the Ministry of Education has increased throughout years, and a considerable portion of this budget has been allocated for wages and salaries. However, the interview and analysis conducted seem to suggest that there has not been a significant

improvement in performance of teachers in Kosovo. A high school was utilized as a case showing that despite the wage increases, the absenteeism of teachers has not decreased, the number of working hours has not increased, there is no significant increase in the participation of students in classes, the Matura Exam results have got worse throughout years, and finally the linear wage increases have discouraged some teachers that believe they deserve higher wage increase compared to their colleagues.

Another outcome was that survey results seemed to support the opinion that Kosovars favor public sector over the private one, where 62% of respondents expressed their preference to work in this sector. In addition, 67% of workers claimed to have been encouraged to move to public sector when public wage bill increased. However, younger respondents showed higher preference for private sector. Therefore, this may be employed to show that provided that private sector is attractive for younger workers, government should not contribute to widening the gap between private and public sector wages because even the people that would prefer giving their contribution in private sector may be induced to not do so because of the combined benefits that private sector seems to lack.

A third outcome was that the public wage increase has caused difficulties for private sector to retain talented workers, has increased the pressure to increase the private sector wages, and influenced the employee turnover. To illustrate this, X Company has lost 87 workers for the last 2 years to different institutions of public sector. Due to the pressure to attract qualified workers, X Company plans to increase the average wage to 500 from January 2017, but it is yet to be shown whether some workers would have to be fired to achieve this.

Even though public sector is the main employer in Kosovo, and the salary provided for its workers may not necessarily account for living expenses, this does not justify the systematic wage increases that are rarely, if ever based on a long term plan. There are several recommendations that can be drawn from this project to tackle the issues related to public wage increases. More resources are to be devoted to ensure that job positions in the public sector are harmonized with job descriptions since some workers get paid for the duties that they do not perform, and consequently this influences the effectiveness of public

sector. Government mechanisms are to be employed to stop the increase in size of public sector because this further increases the burden on private sector as the main source of finance for the compensation of public sector workers. As such, ministries should freeze employment for a period of 5 years. In addition, as representatives of private sector labor union suggested, such ministry should not replace the civil and public servants that retire after the age of 65 years for a period of time. Further, criteria should be set for the number of departments in each ministry and the number of employees in the ministry.

As analysis show, private sector workers' rights are often subject to violation, and this directly influences their desire to contribute in this sector. Consequently, government should take measures to identify and punish such right violations by increasing the number of inspectors in this sector, provided that the current number of inspectors (48) is considered to not be enough to identify the potential violations. In addition, tackling the problem of corruption is essential for improving the business environment in Kosovo. The linkage of identification of informal businesses with rewards is one way of improving the business environment. Thus, the authorities should consider providing performance incentives for tax inspectors that identify and transform businesses that operated informally. This will increase the number of taxpayers, thus contributing to higher revenue for the state, instead of increasing taxes for businesses part of formal market. This would lead to reduced level of corruption, as inspectors would have higher financial stability and as such would not be induced to engage in unethical activities. The government should also provide the mechanisms that would support the development of private sector, so that the private companies would generate higher profit, and thus increase the salaries they provide for their workers.

With the right salary gap between public and private sector, the public sector can motivate private sector to develop and perform better. Provided that public sector salaries have increased rapidly, this demotivates people from finding a job in the private sector as they consider the public sector as a better working environment with faster growing salaries. Therefore, the increases in public wage bill trigger economic slivers when not linked to economic development. As such, Kosovo should consider increasing salaries of public sector workers based on nominal GDP growth. Such recommendation will go into

effect by 2018, where the IMF's public wage bill suggestion indicated that the public wage bill is allowed to grow up to nominal GDP growth. Thus, the rule indicates that the wage bill can increase up to 0.5% when nominal GDP grows by less than 0.5%. With the implementation of such rule, the public sector wage bill to GDP will stay within the levels of regional comparators.

Even though such recommendations may sound simplistic in paper, in reality require willingness and corporation of Kosovo's institution to achieve them. If government will ignore the practice of increasing wages as a means of winning elections, and instead focus on tackling and solving the roots of the issue, the end result will be an effective public sector that corporates with private sector in promoting growth and development for Kosovo.

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VIII. Appendices

Appendix 1: Survey Questions

1. Please select the category that best reflects your age

- Under 18
- 18-30
- 31-40
- 41-50
- Over 50

2. What is your gender?

- Male
- Female

3. What is your highest level of education?

- No Formal Education
- High School Degree
- University Degree
- Post-Graduate University Degree
- Other

4. Do you currently work in the public or private sector? (if private sector go to question 5, if public thank you, you may stop filling the survey)

- Public Sector
- Private Sector

5. Do you work as a part time worker or full time worker?

- Full time
- Part time

6. Have you previously worked in public sector? (if yes continue to question 7, if no go to question 9)

- Yes
- No

7. You no longer work in the public sector because: (if resigned continue to question 8, if you were fired continue to question 9)

- I resigned
- I was fired

8. Please indicate reason(s) below, which contributed to your decision to resign your job position in public sector?

- Salary
- Family Responsibilities
- A Better Job Position in Private Sector
- Frustration with bureaucracy
- The job was not challenging enough
- Other

9. Would you prefer working in the public sector?

- Yes
- No

10. Do you get paid for working extra hours?

- Yes
- No
- Sometimes

11. Please rate the following statements on a scale of 1 (strongly agree) to 5 (strongly disagree)

	1	2	3	4	5
I am paid fairly for the work I do	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
I feel my efforts are appreciated	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
I have the security I need in this job	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

12. How likely would you recommend the company you work to someone else?

- Very Likely
- Somewhat likely
- Somewhat unlikely
- Very unlikely
- Not sure

13. How satisfied are you with (1 = Very Satisfied 2= Satisfied 3= Neutral 4= Dissatisfied 5=Strongly Dissatisfied).

	1	2	3	4	5
Health Insurance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Retirement Plan	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Vacation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Holidays	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Flexible Scheduling	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

14. When public wage bill in Kosovo increased, where you induced to quit your job in the private sector and move to public sector?

- Yes
- No

Appendix 2: Informed Consent Form

**Informed Consent Form for Social Science Research
RIT KOSOVO**

Title of Project: Public Sector Wages: Implications for the Private Sector

Principal Investigator: Drenusha Berisha/AUK Student

Shpetim Rrobaj; Campus Gërnia n.n

049-133-183; drenushab1@auk.org

1. **Purpose of the Study:** The purpose of this research study is to explore how public sector wages influence the private sector in Kosovo.
2. **Procedures to be followed:** You will be asked to answer 5 questions during this interview.
3. **Duration:** It will take about 30 minutes to complete the interview.
4. **Statement of Confidentiality:** Your participation in this research is confidential. The data will be used only to enrich the project and support the statements regarding the public sector wage impact on private sector. In addition, the data from this interview will be used only as part of the research techniques course.
5. **Voluntary Participation:** Your decision to be in this research is voluntary. You can stop at any time. You do not have to answer any questions you do not want to answer.

You must be 18 years of age or older to take part in this research study. If you agree to take part in this research study and the information outlined above, please sign your name and indicate the date below.

You will be given a copy of this form for your records.

Participant Signature

Date

Person Obtaining Consent

Date

Appendix 3: Interview Questions

X High School Representative

1. How do you measure the performance of teachers in your school?
2. Have you noticed improvements in the level of quality of teaching when salaries increased?
3. What are the results of Matura Exam for the last years?
4. Has the number of working hours increased after the public wage bill increased?
5. What is the impact of linear wage increases for teachers in your school?

X Company and Y Company Representatives:

1. Considering that the average public sector wages are higher compared to the average private sector salaries, do you face difficulties in attracting employees to work for your company?
2. Have you encountered higher employee turnover due to public wage bill increase?
3. What is the average salary in your company, and do you plan offering higher compensation in the near future?
4. Are workers in your company offered health insurance and/ other benefits?
5. Are workers paid for extra hours of work, and what can you say about the process of?

The Union of Independent Trade Unions of Kosovo Representative

1. Do you consider that the wage increases in Kosovo are a merit of the union?
2. Why do you request higher public wage bill, and have you requested the same thing for private sector as well?
3. Referring to existing literature, public wage bill influences private sector, so what do you think, what are the implications of public wage increases for private sector?
4. Do you have any statistics regarding the number of workers in private sector that have been let go due to the pressure to increase private sector wages?
5. What are the plans of the union in order to provide support for the private sector workers?

*Note: A number of questions provided above were used for other interviews. Other questions not prepared from the interviewer were asked during the interview as well. There were additional questions or points of clarification.