

# Kosovo's Government

## Budget Reserves



December 2022

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## Purpose

Through this memo, GAP Institute aims to provide more clarity on the types of contingencies and reserves included in the annual budget of Kosovo, patterns and trends of their use over the years, the legal basis, and their pros and cons. Considering that the annual budget should have an early and appropriate planning of expenditures, documenting the needs and reasons of expenditures, the Government has little room to introduce new policies during the year. For this reason, governments over the years have seen these budget lines as opportunities to make allocations even for non-emergency issues.

Based on the applicable legislation and the practice over the years, the following budget reserve lines are used in Kosovo: unforeseen expenditures, recurrent reserves, contingencies and emergency liquidity reserves. The category of **unforeseen expenditures** targets emergency spending, **recurrent reserve** is used to settle decisions of execution authorities, **contingencies** are planned for larger unforeseen expenditures, or to cover the cost of a new law, and the **emergency liquidity reserve** is a Government Fund in the Central Bank of Kosovo to maintain the financial system liquidity. In 2023, a total of 279 million EUR, or 8.7% of total budget expenditures, are expected to be allocated in the contingency lines.

Although situations such as the COVID-19 pandemic and the high inflation required a financial buffer, literature suggests that such reserve and contingency funds do not exceed 3% of total budget expenditures.<sup>1</sup> In addition, allocation of the reserves is suggested to include a description on the intended use of the reserve and a higher transparency on the spending.

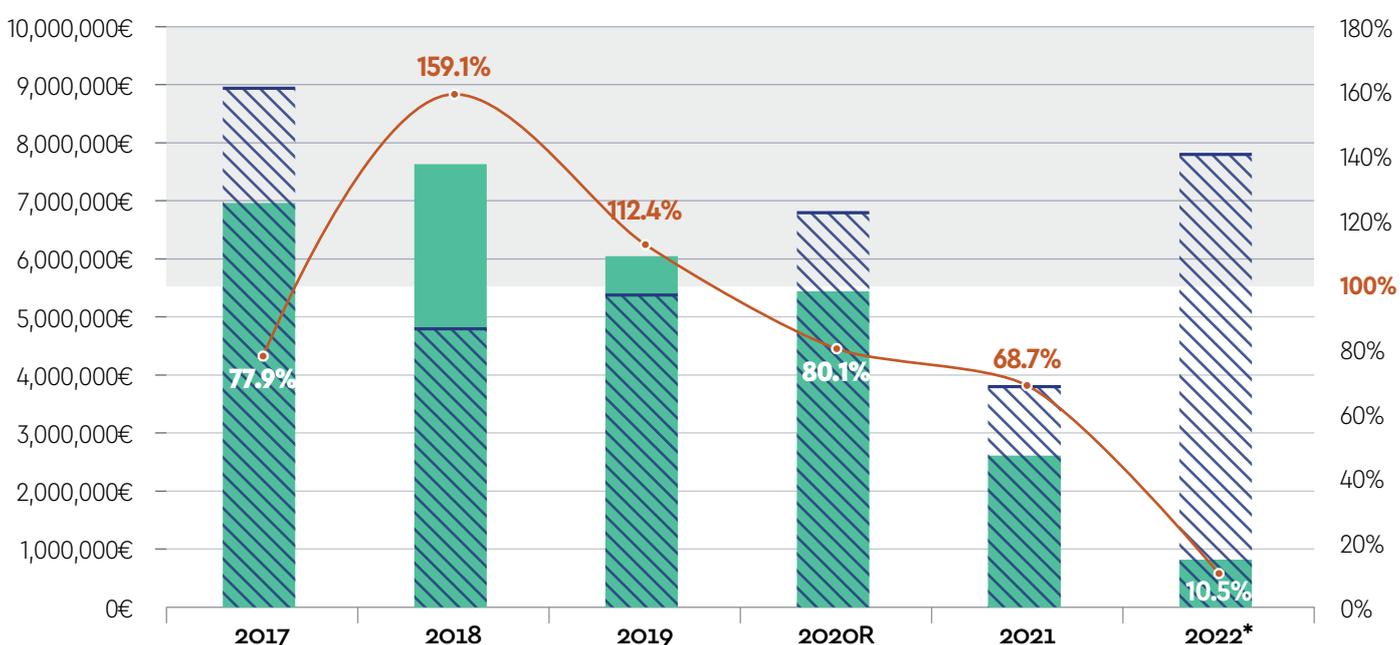
<sup>1</sup> World Bank. Performance-Based Budgeting and Medium-Term Expenditure Frameworks in Emerging Europe.  
Source: <https://bit.ly/3Wwx0Rk>

## Unforeseen expenditures

Unforeseen expenditures are a category of expenses allocated by the Ministry of Finance, Labor and Transfers (MFLT) for urgent or unforeseen needs of budgetary organizations. The allocation of funds is regulated with Law No. 03/L-048 on Public Finance Management and Accountability (LPFMA)<sup>2</sup>, Article 29, which defines how budget organizations apply for them. According to the law, when budget organizations need additional funds which couldn't have been foreseen, they must apply to MFLT, providing an explanation of the reasons that led to the need for additional funds, why such expenditures couldn't have been foreseen, describe how they will contribute to the fulfillment of their objectives, and identify which other budget allocations can be reduced in order to fulfill the demand for the funds. These expenditures can be authorized by the Minister of MFLT after having received prior approval from the Government.<sup>3</sup>

Unforeseen expenditures are planned yearly under the sub-program "Unforeseen expenditures" in the Law on Budgetary Appropriations, in line with Article 29 of the LPFMA. These expenditures are divided into two economic categories: reserves and capital expenditures. Funds are disbursed with a Government decision, based on requests of budget organizations for the year. The Minister of MFLT is authorized to approve transfers from this sub-program into another sub-program for requests in amounts up to 40,000 EUR, provided that the cumulative annual amount doesn't exceed 20% of the annual allocation for this sub-program.<sup>4</sup>

**Figure 1. Government's Unforeseen Expenditures (2017–2022\*)**



**Source:** Ministry of Finance, Labor and Transfers – Annual Financial Reports 2017–2022 and Law on Budget Appropriations 2017–2022

\*For 2022, data until September 2022.

<sup>2</sup> Official Gazette of Kosovo. Law on Public Financial Management and Accountability. Article 29.

Source: <https://bit.ly/3UymGaN>

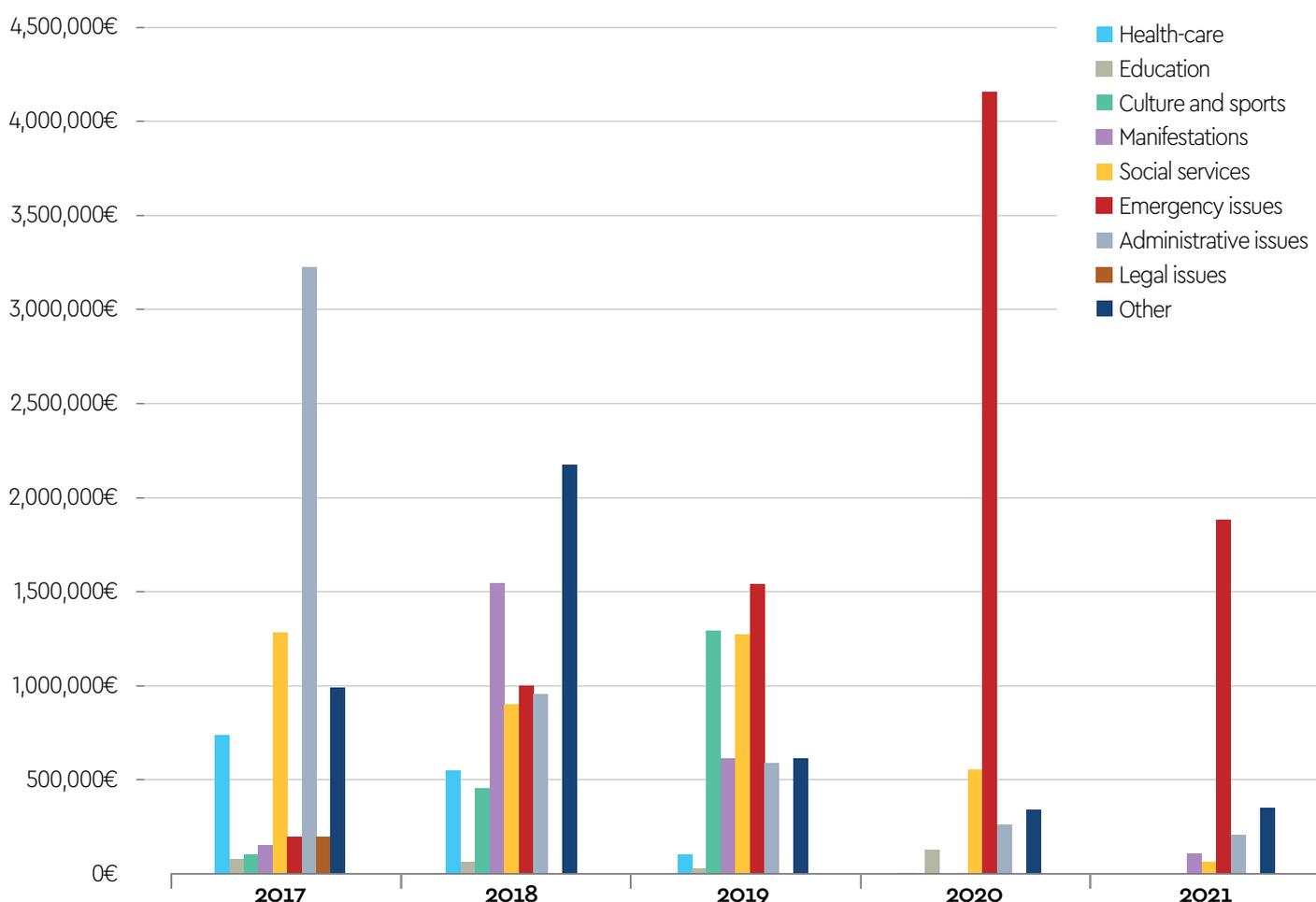
<sup>3</sup> Ibid.

<sup>4</sup> Law on Budget Appropriations of the Republic of Kosovo for 2023. Article 14. Source: <https://bit.ly/3YrXZiJ>

In the period 2017–2022, the annual budgeted average for unforeseen expenditures was around 6.3 million EUR. The highest planned value was in 2017, with 8.9 million EUR, and the lowest in 2021, with 3.8 million EUR. In this period, around 71% of these expenditures were allocated for reserves, and the rest for capital expenditures. In terms of execution, the highest value of unforeseen expenditures was in 2018, with 7.6 million EUR (or 159.1% of the budgeted value). This overrun of expenditures in this category was due to the reallocation of funds during the year, and Government decisions. In the budget planned for 2023, the government has allocated around 6.7 million EUR for this category.

Despite the nature of this category of expenditures and its legal definition, there were many cases over the years where these funds were used for non-emergency reasons, or cases where prior planning could have taken place. Other than for emergencies, other categories of expenditures in which these funds were used in this period include, administrative issues, social services, culture and sports, manifestations, and health. For example, activities financed by this fund also included annual Independence Day and other cultural manifestation, film projects, sport federations, monuments, etc. One possible explanation for this is the lack of clear criteria in the legislation on the use of these funds. This, however, cannot serve as an excuse for the use of these funds which could have easily been planned in the budget.

**Figure 2.** Unforeseen expenditures by category (2017–2021)



**Source:** GAP Institute calculations based on the Annual Financial Reports of the Ministry of Finance and Government decisions

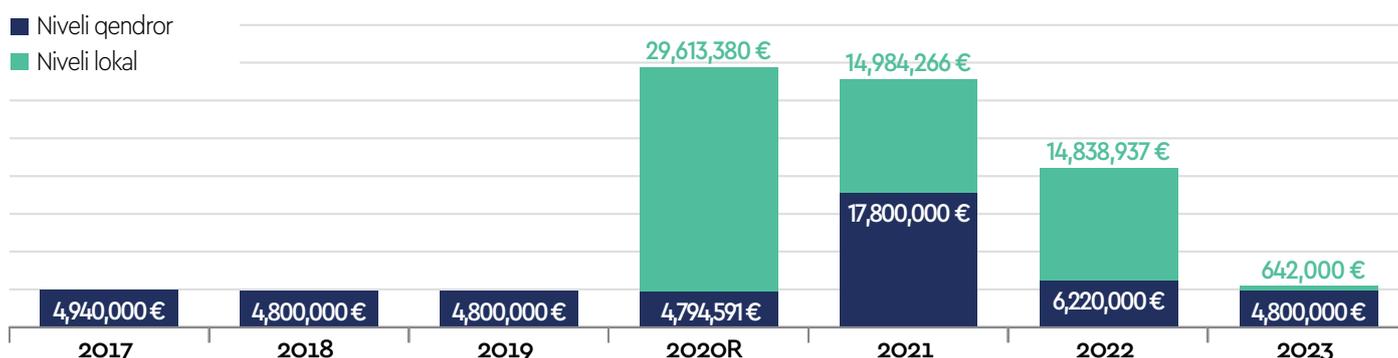
## Recurrent Reserve

The recurrent reserve is a category of recurrent Government expenditures allocated annually for each budget organization at the central and local level. This category of expenditures can be transferred by the budget organization to other categories of expenditures if funds are needed for the implementation of a decision of the executive authorities.<sup>5</sup>

Funds from this category can also be allocated for capital expenditures, after budget organizations provide justification for their capital projects. According to the Law on Annual Budget Appropriations<sup>6</sup> these funds can be transferred with the approval of the Chief Administrative Officer and the Chief Financial Officer of the requesting organization and, in the case of municipalities, after approval by the Municipal Assembly. These transfers of funds are not subject to restrictions under Article 30 of the LPFMA and Articles 15 and 16 of the Law on Annual Budget Appropriations.

In the period 2017–2023, the annual allocated average for recurrent reserves was around 15.4 million EUR. On average, around 55% are allocated to the local level, and 45% to the central level. The highest allocations in this category were in the period 2020–2022, with the highest value of 34.4 million EUR in 2020. In 2023, only 5.4 million EUR were budgeted in this category of expenditures.

**Figure 3.** Recurrent reserve – central and local level (2017–2023)



Source: Ministry of Finance, Labor and Transfers – Law on Budget Appropriations 2017–2023

## Contingencies

Contingencies are another category of budget expenditures listed as a sub-program in the Law on Budget Appropriations, and are funds that the Government keeps as 'reserves' or for 'possible unforeseen expenditures' that may arise due to various factors. This category of expenditures is regulated yearly through the Law on Budget Appropriations, and they are included in the sub-program "Contingencies in the Ministry of Finance, Labor and Transfers" and, in some cases, in special sub-programs. According to Article 15 of this Law, the Minister of MFLT can allocate funds from "Contingencies in MFLT" sub-program to all other budget categories, with an approval by the Government. These funds are also used to cover the financial impact of newly adopted laws.<sup>7</sup>

<sup>5</sup> Law on Budget Appropriations of the Republic of Kosovo for 2023. Article 15. Source: <https://bit.ly/3YrXZiJ>

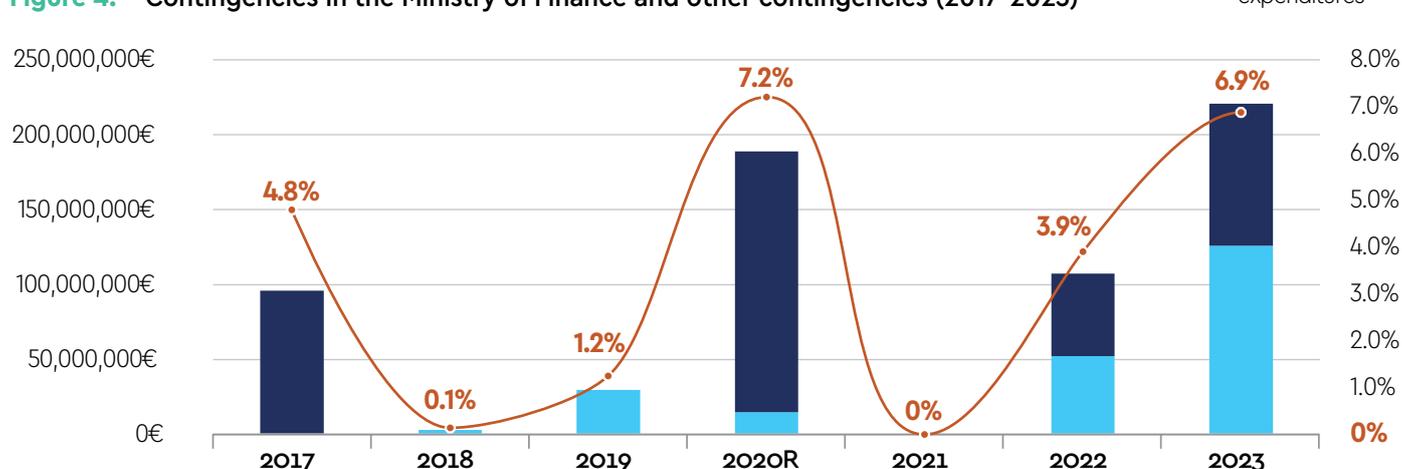
<sup>6</sup> Ibid.

<sup>7</sup> Law on Budget Appropriations of the Republic of Kosovo for 2023. Article 15. Source: <https://bit.ly/3YrXZiJ>

In the period 2017–2023, high fluctuations were observed in the budgeted values for the category of contingencies. In recent years, large amounts have been budgeted in this category, with an average of 130 million EUR per year. A total of 220.7 million EUR were planned in 2023 for contingencies, which is around 6.9% of total budget expenditures, with 125.7 million EUR allocated only for the category "Contingencies in MFLT". Contingencies are usually expected to have a share in the annual budget of around 2–3%.<sup>8</sup> Of these, around 65 million EUR are for wages and salaries, expected to cover the financial impact of the new wage law. Furthermore, around 40 million EUR have been allocated for subsidies and transfers, and 20 million EUR for capital expenditures. Another category of contingencies for which funds are planned for 2023 is energy, with 75 million EUR allocated. These funds are allocated considering the uncertainties with energy and the current energy crisis, and the expectation that it will continue next year.

Similarly, large sums were allocated in this category of expenditures in both 2022 and 2020; 107 million EUR and 188.7 million EUR, respectively. In 2022, around 52 million EUR were contingencies in MFLT, and 55 million EUR contingencies for PAK capital investments and for the investment clause. In 2020, 74 million EUR were allocated as contingency from subsidies, and around 100 million EUR as a capital investment contingency. The high amount allocated for subsidies was due to the pandemic situation at that time, and the uncertainties it had created. The biggest weaknesses on transparency regarding the objective of the budget allocation through contingencies are in the category of capital investments, where there's no clarity on the reason of such allocation, projects with a high likelihood to be funded through this line, etc.

**Figure 4. Contingencies in the Ministry of Finance and other contingencies (2017–2023)**



Source: Ministry of Finance, Labor and Transfers – Law on Budget Appropriations 2017–2023

Despite some cases where contingencies were justifiable for concrete situations (e.g. pandemic, energy crisis), their increase to around 7% of the total budget in recent years has a number of shortcomings. Firstly, a high budgeting in this category of expenditures leaves room for ad-hoc projects of the Government, as the spending of such funds is at their discretion and funds could also be spent for political purposes. Moreover, it is an indication of inadequate planning, as the funds are blocked, may not be spent at all, thus increasing the opportunity cost.

8 World Bank. Performance-Based Budgeting and Medium-Term Expenditure Frameworks in Emerging Europe. Source: <https://bit.ly/3Wwx0Rk>

## Emergency Liquidity Reserve

The emergency liquidity reserve is a Government fund held at the Central Bank of Kosovo, based on a Memorandum of Understanding for Emergency Assistance between the Governor of the Central Bank of Kosovo, the Minister of Finance, Labor and Transfers, and the Chair of the Assembly Committee on Budget, Labor and Transfers. The fund is kept as an emergency reserve to preserve the liquidity of the financial system, and is planned annually in the Law on Budget Appropriations. The amount held in this fund has been the same over the years, at 46 million EUR, and was never been spent.<sup>9</sup>

Spending of Funds allocated for this purpose is also regulated in Article 14 of the Law on the Central Bank of Kosovo, which states that the Central Bank, in exceptional circumstances, in its judgment and following the criteria defined by the Board of the Central Bank, shall act as creditor of last resort for a local commercial bank, providing financial support in emergency cases. However, this support cannot exceed the total amount of reserves determined by the Law on Budget Appropriations, mentioned above.<sup>10</sup>

The spending of funds allocated to the Government's budget reserves is reported on an annual basis in the Annual Financial Report<sup>11</sup> of the Ministry of Finance, Labor and Transfers. Execution of unforeseen expenditures (reserves and capital expenditures) is also presented in a clear and detailed table in the report (stating the budget organization, decision and purpose of the allocation of these funds, as well as the amount). However, the execution of contingencies is not reported as a separate category in the Annual Financial Report, but rather under individual budget organizations and economic categories.

<sup>9</sup> Law on Budget Appropriations of the Republic of Kosovo for 2023. Article 15. Source: <https://bit.ly/3YrXZiJ>

<sup>10</sup> Law on the Central Bank of Kosovo Article 14. Source: <https://bit.ly/3Yscp2h>

<sup>11</sup> Annual Financial Reports. Ministry of Finance, Labor and Transfers. <https://bit.ly/3hLqsGs>

## Conclusion

Budget reserves held by the Government are an important element of the budget, as their purpose is to function as a financial buffer in times of different crises, such as pandemics, inflation, natural disasters, etc. However, their allocation by the Government must be more detailed, with a clear description of the reason for such allocation and, in cases of capital projects, the specific project for which the funds will be used. This applies more to the category of contingencies, as an increase of allocations has been noticed in the recent years. As stated above, according to international financial organizations, contingencies are preferred to be kept at 3% of total budget expenditures.

However, recently, contingencies allocated by the Government were rather high, from 7.2% of the budget in 2020, to 3.9% in 2022, and 6.9% of the 2023 budget. An analysis of all categories of reserves/contingencies indicates that in 2023 they comprise around 8.7% of total budget expenditures. Part of this total, allocated for emergencies (energy crisis this year) is justifiable. However, amounts allocated for other categories of contingencies are considered high, and with a number of shortcomings. This is an indication of inadequate planning, as funds are blocked and, if not spent, there are high opportunity costs as many projects remain unexecuted due to lack of funds. Furthermore, as the spending of these funds lies in the discretion of the Government, a higher budget in this category leaves room for spending on political basis.



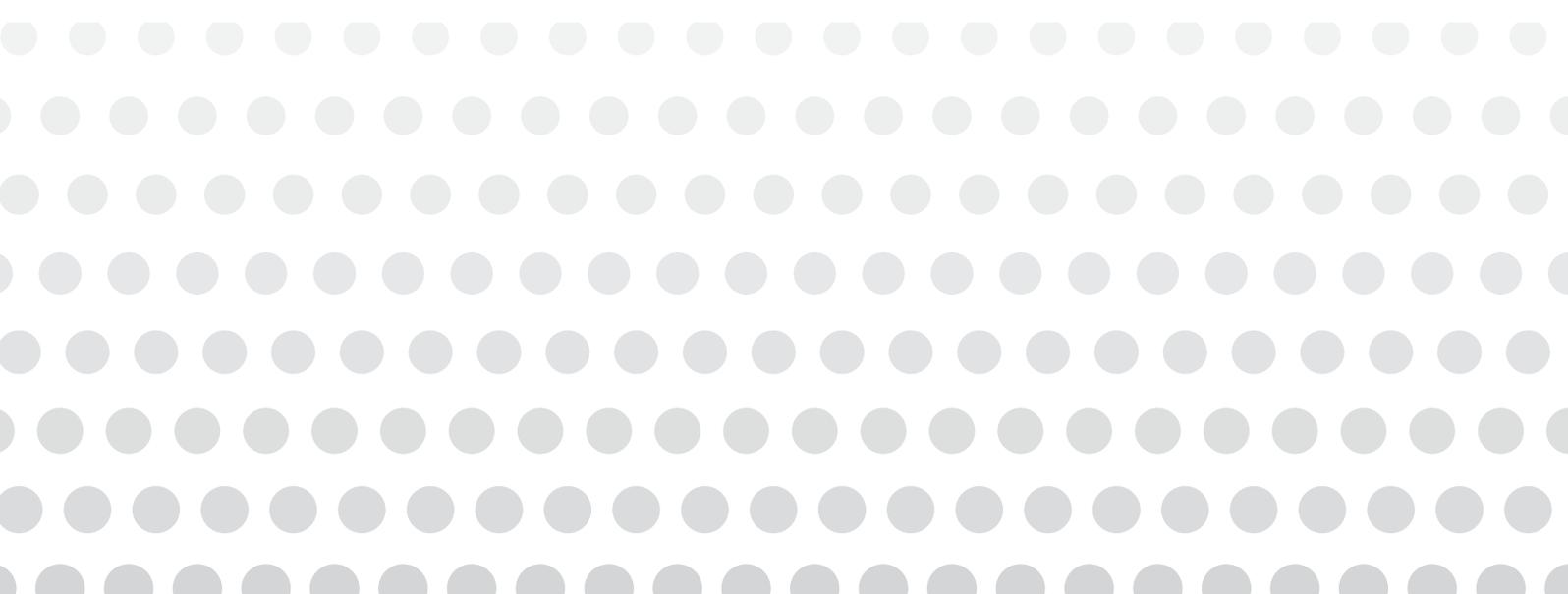
GAP Institute is a Think Tank established in October 2007 in Kosovo. GAP's main goal is to attract professionals to create an environment of professional development and research, as seen in similar institutions in Western countries. This also provides Kosovars with opportunities to research, develop and implement projects in order to advance the Kosovo society. Priority for this Institute is the mobilization of professionals to address the country's economic, political and social challenges. GAP's main goals are to fill the gaps between government and citizens, and between problems and solutions.

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