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July 28, 2015

Statement by Mr. Guyon on Republic of Kosovo
(Preliminary)
Executive Board Meeting 15/78
July 29, 2015

We thank staff for a well-written report and Mr. Canakci and Mr. Mehmedi for their helpful Buff statement. We broadly concur with the thrust of the staff appraisal and support the request for a new stand-by arrangement (SBA). The proposed arrangement will provide crucial support to the Kosovar authorities by ensuring fiscal consolidation, improving the resilience of the financial sector and boosting potential growth.

We would like to offer the following comments for emphasis:

Fiscal policy

The program rightly puts a strong emphasis on the credibility of the fiscal rule, which would have been at risk without several corrective measures. Indeed, since the end of the previous program, not only has the macroeconomic situation in Kosovo deteriorated, but the structural fiscal balance also has deteriorated due to sharp pre-electoral wage and pensions increases, combined with increases in current spending. Besides, those evolutions have eroded space for much needed productive capital spending.

We welcome the authorities' strong commitment to implement the frontloaded fiscal adjustment of the program. In addition to a first set of corrective measures taken in March, further fiscal revenue measures have been adopted in the context of the mid-year budget review. The prior action of voting supplementary budget for 2015 in line with the program objectives as defined in paragraph 5 and 6 of the MEFP has been met. We also support the plan to modify the investment clause in the fiscal rule in order to enable large infrastructure projects.

At the same time, we see downside risks on the medium term budget especially as regards customs revenue while the Stabilization and Association Agreement with the EU has not been ratified yet.

Financial sector

Establishing the financial sector "road map" and fully adopting risk-based supervision of banking sector in compliance with European framework will enhance the regulatory and supervisory framework and help remove structural impediments to bank lending activity.

We welcome staff's proposal to conduct a detailed audit of the remaining obstacles for credit flows which are ingrained in weak business environment, underdeveloped private sector, and limited business opportunities. We are pleased to see that government has already taken some initiatives to address inefficient court processes and difficult debt collection procedures. However, we would have appreciated a more in-depth analysis in the staff report of possible measures to bring down the level of NPLs in order to facilitate banking credits.

Structural reforms

To lift income per capita and make a dent in the large unemployment rate, Kosovo should shift its current growth model from one driven by remittances and consumption to one driven by investment and the tradable sector. Remittances contributed in Kosovo to stimulate consumption and investment mostly in the non-tradable sector and, without a well-established productive and export base, resulted to a very large trade deficit. Remittances might also have contributed to raise the reservation wage above equilibrium level, thus creating labor supply disincentives. In this perspective, we strongly support staff proposal to improve business environment reform focusing in priority on the procurement process to reduce corruption and control public sector wages to improve private sector competitiveness.

However, we regret that the program covers only partially the structural challenges of Kosovo. In particular, we think that reforms in the education and energy sectors, which are not part of the program, are critical to boost potential growth and external competitiveness, and encourage the authorities to take actions in this area.