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10:45 a.m., July 29, 2015

3. Republic of Kosovo—Request for Stand-By Arrangement

Documents: EBS/15/77

Staff: Miniane, EUR; Ghura, SPR

Length: 22 minutes

Executive Board Attendance

M. Zhu, Acting Chair

Executive Directors	Alternate Executive Directors
	N. Tshazibana (AE)
	M. Raghani (AF)
	B. Lischinsky (AG), Temporary
	K. Choi (AP)
	P. Fachada (BR)
	X. Li (CC), Temporary
	C. Hurtado (CE)
	M. Hough (CO), Temporary
I. Çanakci (EC)	
	T. Guyon (FF)
	S. Meyer (GR)
	J. Raj (IN), Temporary
	M. Spinella (IT), Temporary
	T. Hiroshima (JA)
	K. Badsi (MD), Temporary
	R. Faras (MI), Temporary
	J. De Lint (NE), Temporary
	T. Ostros (NO)
	D. Vasilyev (RU), Temporary
	Z. Abdel-Rahman (SA), Temporary
	P. Tangcharoenmonkong (ST)
	J. Adamek (SZ), Temporary
	A. Weller (US), Temporary
	T. Duggan (UK), Temporary

L. Hubloue, Acting Secretary
P. Cirillo, Summing Up Officer
M. Guerra Bradford/L. Briamonte, Board Operations Officers
P. Martin, Verbatim Reporting Officer

Also Present

European Department: G. Cipollone, J. Miniane, R. Vermeulen. Legal Department: N. Stetsenko. Strategy, Policy, and Review Department: D. Ghura, A. Zdzienicka. Alternate Executive Director: C. Just (EC), W. Kiekens (NE). Senior Advisors to Executive Directors: A. Marcussen (NO). Advisors to Executive Directors: M. Mehmedi (EC).

3. REPUBLIC OF KOSOVO—REQUEST FOR STAND-BY ARRANGEMENT

Mr. Çanakci and Mr. Mehmedi submitted the following statement:

On behalf of our Kosovar authorities, we would like to thank management and staff for the constructive discussions and their support for a new 22-month Stand-by Arrangement (SBA) in the amount of SDR147.5 million (250 percent of quota). While Kosovo is in a solid fiscal and financial position, the new arrangement with the Fund will build upon the progress accomplished over the recent years while further strengthening the macro-economic framework and accelerating the implementation of structural reforms.

In this vein, the SBA will support the authorities' continued commitment and efforts to maintain fiscal stability through a front-loaded fiscal adjustment, in order to preserve the credibility of the fiscal rule and maintain low levels of public debt, improve the quality of the budget by increasing the share of more productive spending, rebuild government bank balances to prudential levels, and further enhance the financial safety net and banking system supervision. The program also envisages a realistic set of structural policy reforms that are aimed at expanding Kosovo's productive and export capacity through tackling the country's wage and nonwage competitiveness gap and improving the business environment and governance.

In order to address Kosovo's significant development needs, the program design also allows for a prudent increase in fiscal space for much needed development projects, through the modification of the existing investment clause within the broad-based fiscal rule, while preserving debt sustainability.

With a grand coalition in place which enjoys a comfortable majority in the parliament, and with no general elections scheduled until 2018, there is political commitment to move ahead with a comprehensive reform agenda which will lift Kosovo's growth potential and ensure inclusive and sustainable development. Indeed, at the beginning of 2015, the government approved its four year program which includes a comprehensive set of reforms, including the fiscal, financial and structural reforms that are part of the proposed SBA, illustrating the authorities' commitment to elevate their reform-agenda and program ownership, which is key to its successful implementation. The authorities remain committed to address any potential risks to the program.

A revised mid-year budget, a prior action for the program, has been approved by the parliament on July 16, including all the fiscal measures outlined in the Memorandum of Economic and Financial Policies.

Macroeconomic Developments and Outlook

Kosovo has enjoyed a much more resilient economic growth than other Western Balkan countries, being the highest growth performer in the region with a five-year average growth rate of 3.5 percent. Nonetheless, income per capita remains low while the unemployment rate, especially among the youth, remains relatively high.

In 2014, economic activity slowed down due to political uncertainty and is estimated to have grown by 2.7 percent, mainly driven by remittances, particularly from Germany and Switzerland where most of the diaspora resides, and consumption. The authorities are more upbeat than staff regarding the outlook. They expect growth to accelerate to 3.8 percent this year, supported by continued remittances, an increase in consumption due to the strong impact of last year's public wage increase, and an increase in public investment as a result of the construction of the highway which links Pristina to Skopje. Implementation of the ambitious reforms is expected to yield results in 2016 with a projected growth rate reaching 4.1 percent. The authorities' macroeconomic baseline scenario shows some upside risks, including the start of the Brezovica Resort project, a year round ski resort (approximately 8 percent of GDP), which is expected to generate considerable numbers of jobs and create new opportunities for SMEs.

Low energy and import prices (a key component of the CPI basket) have kept inflation low. A modest inflation of 0.2 percent is expected for this year, which will gradually climb to 1.3 percent in 2016. The current account deficit (CAD), including official transfers, is expected to narrow marginally to around 7.5 percent of GDP in 2015 but will then widen in 2016, as the Brezovica resort project and new donor-financed investments will trigger an increase in imports. However, the financing sources for the CAD are stable and non-debt creating, with the main contributions coming from remittances, official transfers, and FDI. With a considerable trade deficit, approximately 32 percent of GDP, the authorities' efforts are aimed at increasing domestic production and expanding the export base, which would ultimately reduce the trade imbalance and substitute some of the imports.

The Stabilization and Association Agreement (SAA) with the European Union (EU) has been approved by the EU Commission and is expected to come into effect in 2016. The SAA will serve as a blueprint for economic and administrative reforms while opening up EU markets to Kosovo's companies and products, and facilitating free trade.

Fiscal Policy

The authorities attach utmost priority to maintaining macro-fiscal stability and preserving the credibility of the fiscal rule which sets an overall ceiling on the general government deficit at 2 percent of GDP. In this context, fiscal adjustment will be at the core of the program in order to strengthen public finances, rein in current spending, and improve the composition of the budget.

The proposed SBA envisages a front-loaded fiscal adjustment in the order of 1.5 percent of GDP for this year, to bring down the fiscal deficit close to 2 percent of GDP, as envisaged with the fiscal rule. In the absence of corrective measures, the deficit this year would reach 3.9 percent of GDP due to last year's increases in public sector wages and too optimistic revenue projections. A further fiscal adjustment of 0.8 percent will be targeted in 2016 in order to attain an overall fiscal deficit of 1.6 percent of GDP.

Aside from the corrective measures taken in March, such as the increase in the excise taxes on tobacco, alcohol, vehicles, and heavy oil, further fiscal revenue measures have been legislated in the context of the mid-year budget review. The standard VAT rate has been increased from 16 to 18 percent while a differentiated rate (at 8 percent) for a limited category of goods and services has also been introduced and the net effect will yield 0.4 percent of GDP in annualized gains. Excise taxes on tobacco and gambling have been further increased and all these measures will yield more than 0.3 percent of GDP annually. On the expenditure side, current spending has been reined in by savings in transfers (0.2 percent of GDP) and goods and services (0.2 percent of GDP). The authorities have frozen the wage bill and have taken the decision not to fill vacancies this year, measures which will yield another 0.5 percent of GDP in fiscal savings. Public sector wages will be maintained constant in nominal terms also in 2016, thereof decrease public sector wages as a ratio to GDP from 9.6 percent to 8.8 percent.

A large part of the purchases under the SBA will be used to rebuild the low government bank balances at the central bank. In line with the methodology for assessing the adequacy of the cash balances, the program aims at restoring the bank balance to 4.5 percent of GDP by the end of 2016 (from the current level of 1.8 percent of GDP).

In order to tackle unproductive current spending, improve the budget structure, and create more space for growth-enhancing capital expenditures, the authorities will approve by the end of this year a public wage rule that will link growth in the public wage bill to a macroeconomic indicator. The wage rule will keep public sector wages in line with productivity dynamics and enhance the competitiveness of Kosovo’s economy. Importantly, the rule is intended to prevent large discretionary increases in the public wage bill, as seen prior to the elections in 2014 and 2011. Due to the wage freeze in 2016, the rule is intended to be implemented with the 2017 budget.

With the aim of addressing Kosovo’s large infrastructure needs and providing financing for growth-enhancing capital projects, the investment clause of the fiscal rule will also be modified to allow new donor-financed capital projects, in addition to privatization-financed investments, not to count as an excessive deficit against the fiscal rule. The amendment to the rule includes safeguards regarding the approval of the projects, vetting procedures and debt sustainability. Given Kosovo’s large infrastructure gap and social needs, and a very low level of public debt (10.4 percent of GDP), the IFI-financed projects, aimed at sectors such as agriculture, road and railway infrastructure, health, and IT will provide the desirable impetus for growth and job creation.

Several measures are being enacted with the objective of strengthening the tax administration and customs, including the medium-term goal of unifying these two revenue administrations, broadening the tax base, increasing compliance and preventing and reducing the informal economy. The operational departments of both Tax and Customs have been merged and the IT systems have been revamped, as to produce efficiency gains and narrow the tax gap. The authorities have requested Fund technical assistance on the full merger of the revenue-collecting agencies.

Financial Sector

Banks in Kosovo are well capitalized, liquid, and profitable and they follow a traditional banking model (loan-to-deposit ratio of 76.1 percent). The system’s capital adequacy ratio stands at 19.2 percent (end of May), among the highest in the region, with all banks, both domestic and foreign, above the regulatory minimum. The aggregate liquid assets cover 43 percent of short-term liabilities, a key consideration in a euroized economy, and profitability remains high (return on equity at 27.2 percent). Non-performing loans (NPLs) have been declining and are now at 7.4 percent and are fully provisioned. While the interest rate on loans has dropped by around 50 percent in the last three years to 7.9 percent, interest rate spreads are still elevated.

While good progress has been made in improving the financial sector's regulatory and supervisory framework, in large part due to the Fund's technical assistance, further efforts are needed in strengthening the financial safety net, crisis preparedness and crisis management. As part of the program, the Central Bank of Kosovo (CBK) will approve a new legal framework for Emergency Liquidity Assistance (ELA), in line with best practices, which will govern the conditions, processes, and modalities of any emergency assistance provided to banks. Additionally, letters of comfort from parent banks of local subsidiaries have been received which stipulate that parent banks would work with their subsidiaries in the event of a liquidity crisis. Collaboration with foreign bank supervisors, including the Turkish, German, and Austrian supervisory authorities (the origin of most foreign banks) is also being enhanced as to identify risks and vulnerabilities.

Banking supervision and oversight will also be enhanced. The CBK will fully adopt risk-based supervision by mid-March next year, a key recommendation of the 2012 FSAP, which will strengthen financial stability and help the CBK to conduct better surveillance of banks and cover risks on a more consolidated basis.

Despite banks' ample liquidity, credit penetration in Kosovo remains low at 35 percent of GDP, mainly due to structural problems, including lengthy and costly court proceedings, difficult debt collection procedures, and high interest rate spreads and collateral requirements. In order to better utilize the high levels of liquidity in the banking sector, several policy actions are being envisioned in order to tackle the binding constraints to credit access and growth. A private bailiff system, recently introduced, will be further enhanced as to speed-up the enforcement of collateral recovery while the NPL recovery and write-off procedures will be revised. In order to address the current backlog of bank cases which stretch up to five years, measures are being considered to improve the courts' proceedings of commercial cases. In addition, the authorities, with the support of donors, are in the process of establishing a credit guarantee scheme for increasing access to credit for SMEs.

The Kosovar authorities remain committed and are working with staff to further develop the macroprudential toolkit and strengthening the crisis management framework. The recently created Macroprudential Advisory

Committee will adopt its policy framework, with specific indicators, by the end of this year while plans to functionalize the National Committee for Financial Stability and Crisis Management are underway.

Structural Reforms

The authorities acknowledge that for Kosovo to move to a growth model which is driven by investment and the tradable sector, decisive reforms are needed to increase the productive and export capacity of the economy, strengthening the private sector, and improving competitiveness. The government approved its four year program at the beginning of the year while the Economic Reform Program 2015 (ERP), along with its action plan, was submitted to the European Commission in January and provides a platform for the implementation of structural reforms aimed at boosting growth and jobs. The authorities intend to focus their interventions on improving governance and the business environment, reducing skills mismatch, and ensuring an adequate supply of energy.

Measures are being implemented to improve the oversight and control of the public procurement process which will reduce the perception of corruption and provide a level and transparent playing field. In this regard, the procurement law will be amended to ensure its full compliance with international standards and make e-procurement mandatory for all central government agencies, beginning next year. The procurement process at the central level is also being centralized, with the tendering process for three main goods (fuel, office supply, and plane tickets) already initiated.

Despite major improvements in enhancing the business and investment environment in recent years, further reforms are being envisaged to tackle some of the remaining binding constraints to private sector growth such as resolving insolvency, enforcing contracts, and electricity supply. The National Council on Economic Development, a public-private dialogue mechanism which consists of representatives from the government institutions and the business community, has been reactivated and is meeting on a regular basis and coordinating these reform efforts.

In view of Kosovo's high unemployment rate and low labor participation rates, improving the labor market and enhancing the quality of education are essential. Aside from the introduction of the new public sector wage rule which will reduce labor costs and boost competitiveness, the education system curricula (for primary and secondary level) is being upgraded in order to make it responsive to the market needs and reduce skills mismatch.

The vocational educational system is also being revamped, based on the German model, and a new Agency on Vocational Training has been established, coordinating the efforts of the Ministry of Education, the Ministry of Labor and chambers of commerce. Additionally, active labor market policies aimed at increasing female participation in the labor market are being designed.

Lastly, in collaboration with the World Bank, the authorities are moving forward with the energy reforms in order to ensure a sustainable and reliable energy supply. The tendering process for building a new thermo-power plant (600 MW) is in progress while the new regional transmission line with Albania will be completed next year.

Mr. Beblawi and Mr. Faras submitted the following statement:

Kosovo’s program aims at supporting macrofinancial stability and increasing the country’s growth prospects. We support the proposed decision, and highlight the following issues:

Fiscal Policy

A prudent fiscal adjustment is an essential component of the program. The sharp increase in current spending in the run-up to the 2014 elections threatened the credibility of the fiscal rule, and pushed the fiscal deficit to 3.9 percent of GDP in 2015. We welcome the measures already taken, along with those to be incorporated in the revised 2015 budget, to raise tax revenues and lower current spending which are aimed at reducing the deficit to 2.4 percent of GDP. We also look forward to the modification of the fiscal rule to accommodate higher capital spending without undermining debt sustainability. We welcome the inclusion of safeguards to limit the scope for pre-electoral excesses ahead of the 2018 elections, as noted by staff.

Financial Sector

We welcome the authorities’ steps to enhance the regulatory and supervisory framework. The planned adoption of a new legal framework for Emergency Liquidity Assistance is particularly important for a euroized economy. The low credit penetration rate, despite ample liquidity, suggests that there is significant scope for the financial sector to support growth. This will be facilitated by improvements in the business environment and creating more investment opportunities. In this regard, we look forward to the work that staff intends to undertake in the coming months to assess the legal and structural impediments to credit provision and identify possible solutions.

Competitiveness and Structural Reforms

We note that the program includes a nominal wage freeze, to be followed by a public wage rule. We concur with staff that restoring Kosovo's competiveness requires, among others, deflating labor costs and linking the growth of public sector wages to well-defined macroeconomic indicators. We would be grateful for staff elaboration on the criteria that will be used to lift the wage freeze, and whether future increases in wages will be contingent on the adoption of a wage rule. Reforming the public procurement process, as planned under the program, would help to improve transparency and curb corruption. Implementing safeguards to enhance the efficiency of using public funds to upgrade infrastructure in areas of high priority is also encouraging. Nevertheless, restoring competitiveness may require structural reforms beyond the areas of public wages and procurement. Does staff believe that the measures listed in the report are sufficient to restore competiveness and, if not, what else should be considered?

With these remarks, we wish the authorities success in implementing their economic and reform program.

Ms. Tshazibana and Ms. Dlamini-Kunene submitted the following statement:

We support Kosovo's request for a Stand-By Arrangement having considered the challenges faced by the country and the need for reforms to restore fiscal credibility and debt sustainability. However, cognizant that some reform efforts achieved under the staff-monitored program (in 2011) and a Stand-By Arrangement (from 2012) were undermined by the pre-election promises, we encourage the authorities to commit to full implementation of the program by ensuring strong political buy in and ownership. We thank Mr. Çanakci and Mr. Mehmedi for his informative statement and make the following remarks.

On the fiscal side, we encourage the authorities to adhere to the proposed fiscal rules. The rules will provide an operational framework for safeguarding fiscal sustainability post program and make the budget process more credible. A steadfast privatization plan could contribute to improving fiscal balances and rebuilding fiscal buffers in the short run. In addition, tilting the composition of spending toward capital investment would set the stage for a more sustainable growth path. Further, enhancing controls in public procurement processes and strengthening public finance management will help minimize the prevalence of corruption and improve the quality of public spending.

While the banking sector remains liquid and well capitalized, enhancing financial sector stability and encouraging deeper financial intermediation will remain critical for Kosovo over the medium term. We note that the program will endeavor to strengthen the supervisory framework and reduce impediments to lending. We also note that parent banks are ready to assist their subsidiaries in the event of a liquidity crisis. That said, macroprudential policies will remain critical in augmenting the limited monetary policy in Kosovo. Hence we are encouraged by the assurances of the authorities' commitment in Mr. Çanakci and Mr. Mehmedi's statement.

Finally, we urge the authorities to continue structural reforms to reduce Kosovo's dependence on remittances and import oriented consumption. Implementation of structural reforms that will encourage investment and development of the tradable sector will mitigate the adverse effects of high unemployment and will help reduce the informal sector.

Mr. Chodos and Mr. Vogel submitted the following statement:

We are pleased to see the stability and resilience exhibited by Republic of Kosovo during these past years. Looking at the future, Mr. Çanakci and Mr. Mehmedi's helpful buff statement is reassuring on the authorities' intention to reinforce stability and pave the way for higher potential growth, with the new arrangement with the Fund building upon the substantial progress made by the country. At the same time, the buff statement and the staff report highlight the substantial economic, political and social challenges that Kosovo will have to face.

Until 2014, consumption had increased at a higher rate than investment in what the staff underscores the country's "remittance and consumption growth cycle." Measures under the Stand-By Arrangement will lessen pressures on consumption and we observe that it is the authorities' intention to move to a growth model which is driven by investment and the tradable sector. In this regard, we note that increases in investment this year and especially in 2016 will be much higher than those of consumption. Could the staff elaborate more on these changes of trends and projections? We notice that one important factor that could be behind the assumptions is the greater role of public investment and, in this regard, the modification of the investment clause of the fiscal rule that allows an increase in fiscal space for much-needed development projects, as noted by Mr. Çanakci and Mr. Mehmedi.

The staff report underlines that “there is now political support for reforms to lift Kosovo’s growth potential.” Perhaps this environment is part of some of the measures taken in recent months. Among other things, the staff speaks about new benefits for war veterans and political prisoners, a “generous” collective agreement on labor relations, and the introduction of a health insurance law. We are not in a position to assess the “generosity” or “fairness” of the measures, but it is clear that political and social sustainability generate the necessary conditions for economic sustainability. The staff report seems to recognize the issue stating that “a shift in the political climate, together with social opposition toward wage and benefit freezes, could present stronger challenges to implementation than currently exits.” The staff’s comments on this apparent trade-off are welcome.

The staff report also mentions “significant measures this year to bring the 2015 deficit down.” These adjustment measures include an increase in the standard VAT rate from 16 to 18 percent. Could the staff remind us about Kosovo’s evasion rate and informality? Have there been any changes in this regard over the past years? The responses to these questions are critical to assess the likely effects of this measure.

We welcome the authorities’ efforts to strengthen the financial safety net and bank supervisory framework and the program’s intention to remove structural obstacles to bank lending, which is an important issue to encourage the creation of small-and-medium enterprises and employment. We note that there a lot of things to do in this area, where Kosovo exhibits the lowest credit penetration among the Western Balkans.

With these comments, we support the proposed decision and wish Republic of Kosovo and its people every success in their future endeavors.

Mr. Haarsager and Mr. Weller submitted the following statement:

We support the proposed SBA and its focus on reversing the deterioration in Kosovo’s fiscal accounts and making the composition of spending more conducive to balanced growth. A reduction of wage costs, in conjunction with efforts to address business climate impediments, will also be needed to improve Kosovo’s competitiveness and transition the economy away from excessive reliance on the non-tradable sector as an engine of growth.

The reductions in the wage bill and VAT reforms proposed by the staff are welcome in view of sharp increases in current spending, the large decline in revenue-to-GDP, and the inflation of public wages. We are especially pleased, as noted by Messrs. Çanakci and Mehmedi, that public sector wages will be held constant in nominal terms through end-2016, and shrink as a percentage of GDP. We note, however, that the VAT increase includes a number of exemptions that could undermine the revenue potential of this initiative. Can the staff elaborate on the nature of the exemptions and the resulting foregone revenue? In light of the recent increase in subsidy spending, we would also appreciate the staff's view of the scope for reducing this expenditure item. We do not object to the front-loaded trajectory of consolidation, the absence of which would lead to a large breach in the fiscal rule, but note that despite a fiscal consolidation of 1.5 percent/GDP in 2015, staff forecasts a 0.5 percentage point increase in GDP growth. Are fiscal multipliers fairly low in Kosovo?

The decrease in current expenditure should allow a needed replenishment of the government's depleted bank balance and reorientation of spending to capital investment. We are receptive to the proposed relaxation of the fiscal rule to permit an increase in donor-financed infrastructure spending above the deficit ceiling. Greater external borrowing should be matched, however, by continued improvements in the capacity of the government to evaluate the economic and social returns of investment projects. We appreciate the various safeguards proposed by the staff to ensure good use of fiscal space and preserve debt sustainability.

Remittances have helped to support growth and offset a large trade deficit, but they have also driven reservation wages to uncompetitive levels, undermining private sector job creation. The staff's rules-based wage setting mechanism will help to prevent large discretionary public wage increases. However, the mechanism must be structured in a way that avoids excessive upward wage rigidity that could pose a fiscal burden and further damage competitiveness. We note, in addition, that even if the authorities succeed in restraining public wage growth, strong remittance inflows will continue to put upward pressure on overall reservation wages. Are there other policy measures that could reduce reservation wage levels? We strongly support the staff's proposed procurement reforms, which should help to reduce corruption and improve the business environment.

We welcome steps taken by the authorities to improve risk-based financial supervision, and encourage them to address the structural barriers that impede private sector lending. In light of Kosovo's euroized economy and the central bank's inability to print money, it is important for the authorities to have ample reserves to provide emergency liquidity assistance (ELA) to financial institutions, if needed. In this respect, we are pleased that the central bank has committed to adopt a new ELA framework consistent with international standards. How will ELA reserves be sourced/financed?

Mr. Snel and Ms. De Lint submitted the following statement:

We would like to thank staff for an informative report and Messrs. Çanakci and Mehmedi for their helpful buff statement. As discussed recently in the Article IV consultation Board meeting, the Republic of Kosovo is in many respects in a solid position, but at the same time, the country faces some significant challenges. The fiscal position needs to be strengthened and the growth model needs to be diversified. To tackle this dual challenge and to cover the balance of payments needs over 2015-17, we support the request for a Stand-By Arrangement and the program objectives. As we had the opportunity to discuss the economic situation in the Republic of Kosovo in detail on the occasion of the Article IV consultation Board meeting, we limit ourselves to remarks on the fiscal policy, a key element of the program.

Fiscal consolidation to bring the budget deficit down and within the bounds of the fiscal rule will ensure credibility, debt sustainability and restore government bank balances to an adequate level. The planned measures to reduce the 2015 deficit from 3.9 percent to 2.4 percent seem appropriate. Also the plans to further adjust in 2016 are sensible. The combination of the fiscal rule and the new wage rule provide some protection against fiscal slippages, but we would like to stress that continuation on a prudent path is important, especially in the run up to next elections.

We support the modification of the investment clause of the fiscal rule. Allowing for new donor-financed capital projects, in addition to privatization-financed projects, creates more room for development projects. We support the safeguards that spending under the clause can only take place unless the deficit is below 2 percent of GDP and government bank balances are above 4.5 percent of GDP. We understand from the staff report that the government's bank balances will only return to 4.5 percent of GDP by the end of 2016, which means that only after 2016 the planned projects can be implemented. Could staff elaborate on how this affects the program objectives, as these investments are seen as priority spending?

Mr. Cottarelli and Ms. Spinella submitted the following statement:

We thank staff for the candid report and Mr. Çanakci and Mr. Mehmedi for their informative buff statement.

We support Kosovo's request for a 22-month Stand-By Arrangement (SBA) for SDR 147.5 million (250 percent of quota) aimed at strengthening macroprudential stability, stabilizing the country's balance of payments and promoting sustainable growth.

Ensuring the credibility of the fiscal rule and improving the budget composition is at the core of the program: current spending needs to be curbed while investments preserved and boosted. We welcome the authorities' commitment to avoid in the future large discretionary increases in current spending (as with public wages in the periods preceding the elections in 2011 and 2014) also by means of adopting rule-based mechanisms that regulate the increases in the public sector wages and of introducing a centralized e-procurement process to improve public governance (structural benchmarks).

We also see merit in the measures underway to strengthen the financial supervisory framework, moving towards risk-based supervision, the adoption of a new legal framework for emergency liquidity assistance, and the development of a macroprudential toolkit that will strengthen the role of the CBK.

We encourage the authorities to undertake reforms that would support credit supply to the economy. This would also help emancipate the economy from excessive reliance on remittances from the diaspora, which, in the long term, could prove detrimental to stimulate entrepreneurial activities.

Finally, we echo staff in recommending the authorities to further strengthen the AML/CFT framework and consider undergoing a comprehensive anti-money laundering assessment against the new FATF risk-based methodology.

Mr. Heller and Mr. Adamek submitted the following statement:

We support Kosovo's request for a 22-month Stand-By Arrangement (SBA). Shifting from the current remittance-based growth model to one that is increasingly driven by investment and trade is necessary, to generate sufficient economic growth and jobs in the medium-term. At the same time, macrofinancial stability must be maintained. The program will provide crucial support to the Kosovar authorities in achieving this, by facilitating efforts to (i) boost productive capacity and competitiveness through structural reforms, and (ii) bolster economic resilience through measures to improve fiscal policy, rebuild government bank balances, and strengthen the financial safety net and supervisory frameworks. We broadly agree with staff's assessment and confine ourselves to the following remarks:

Fiscal consolidation, combined with improving the composition of spending, is paramount. We are concerned that for years the public wage bill has increased, while urgently needed capital spending has decreased. 2014 saw a continuation of this problematic pattern, and the fiscal situation and outlook deteriorated. We therefore endorse the fiscal policy envisaged under the program, which will (i) curb budget deficits in consistency with the fiscal rule, thus maintaining debt sustainability, and (ii) preserve capital expenditure and make room for further donor-financed investment. We welcome that a revised mid-year budget was recently approved by the parliament as a prior action for the program, as mentioned in the buff statement of Messrs Çanakci and Mehmedi. Moreover, we support the introduction of a public wage rule and the requested modification of the fiscal rule. With regard to the latter, we welcome technical support by the Fund.

We welcome the planned reforms to the public procurement process and the authorities' efforts to fight corruption. We agree that the recent adoption of a general procurement law in line with international best practice provides a good starting point in this regard. Continued progress under the program will be essential, to further enhance the business environment and thus build on recent improvements in the World Bank's Doing Business and governance indices. Apart from that, we join staff in encouraging the authorities to undergo a comprehensive AML/CFT assessment against the revised 2012 FATF standard, to further strengthen the AML/CFT regime.

Maintaining political support will be critical for success. Conducting structural reforms and restraining unproductive fiscal spending is indispensable, to improve the medium-term growth prospects of the Kosovar economy and preserve macrofinancial stability. To this end, politically difficult measures will have to be taken. The grand coalition formed in December 2014 provides a window of opportunity to implement such measures. We welcome the authorities' strong commitment to the program goals. Meanwhile, we stress the need for sustained political support for the reform agenda beyond the program, particularly in the run-up to the elections in 2018.

Mr. Ostros and Ms. Jonsdottir submitted the following statement:

We support the Kosovar authorities' request for a Stand-By Arrangement amounting to 250 percent of quota. A sustainable growth model for Kosovo requires a shift from remittances and consumption to capital investment, particularly in the tradeable sector. Amid a run-down of government bank balances, the program will support the rebuilding of buffers through the compression of unproductive current spending, while structural reforms foster the development of private sector initiatives. The plan also allows for a reorientation towards capital expenditure. Only by increasing competitiveness and expanding the productive and export base would per capita income be significantly impacted in the longer term. We thank staff for the report and agree with the staff appraisal.

The program's aim to maintain the integrity of the fiscal rule is welcome. While we regret the deterioration of current expenditures in the run-up to the last elections, we note that the grand coalition has a comfortable majority of seats in parliament and hence there is every reason to expect strong ownership and firm implementation of the necessary actions. Further expenditure and revenue measures for 2015 are estimated by staff to yield 1.5 percent of GDP in adjustment while preserving capital expenditure. We welcome that with the approval of the revised mid-year budget, all prior actions have been met, as mentioned in Mr. Çanakci and Mr. Mehmedi's buff statement. We support the proposed public wage rule to become effective when public wages have reached the appropriate levels in real terms, although we look forward to further information on the chosen macroeconomic indicators. The staff's comments are welcome.

We agree that Kosovo's infrastructure needs should be accommodated by a modification of the investment clause of the fiscal rule. In addition to privatization receipts, new donor-financed capital projects would be exempted when considering the fiscal deficit. However, we emphasize the importance of adhering to the proposed safeguards, honoring the required underlying deficit and government bank balances, public debt ceilings and the good use of fiscal space that is reflected in the required majority for approval in parliament.

While the financial sector is sound, with ample liquidity and decreasing NPLs, bank intermediation could be strengthened and the financial safety net improved. This would require establishing an emergency liquidity assistance framework in line with international best practice and assisting the authorities in adopting risk-based supervision. Efforts to strengthen legal frameworks, including a new bankruptcy law and the increased provision of training for the judiciary in addition to privatized debt collection are likely to alleviate bottlenecks and lead to lower interest rate spreads. We welcome the Fund's intention to map out legal and structural impediments to credit provision.

Tackling perceptions of corruption would foster private sector development. We note Kosovo's significantly improved rankings on the World Bank's Doing Business and governance indices in recent years. In addition to public sector wages more in line with private sector developments and a stronger financial intermediation role for the banks, which will support private sector development, we particularly welcome the new public procurement process which is likely to decrease perceptions of corruption even further. We look forward to further implementation of the general procurement law as the process becomes increasingly centralized and will bring in municipalities and publicly-owned enterprises, as well as the adoption of mandatory e-procurement for all central government agencies that is expected to be legislated by the second review.

Mr. Alshathri and Mr. Abdel-Rahman submitted the following statement:

We thank staff for a well-written report and Mr. Çanakci and Mr. Mehmedi for their informative buff statement. We support the Kosovar authorities' request for a 22-month SBA with access of 250 percent of quota to support the implementation of their economic reform program. Promoting higher and more sustainable economic growth and job creation in Kosovo would hinge on economic reforms to enhance the economy's resilience to shocks and boost external competitiveness. Towards that end, we note that the program rightly seeks to support a growth friendly fiscal consolidation, bolster financial sector stability, and improve the environment for private businesses in the tradable sector. We also take good note of the authorities' commitment to strong program implementation and to address any potential risks to the program as emphasized in Mr. Çanakci's statement.

On fiscal management, we are encouraged that the fiscal adjustment envisaged under the program to safeguard fiscal sustainability does not compromise the space for critical development spending. In particular, we note that the adjustment focuses on improving the composition of public spending through streamlining recurrent spending. We are also encouraged to learn from Mr. Çanakci's statement that the authorities are enacting measures to improve tax and customs administration and to broaden the tax base, which should help enhance the space available for high priority development spending. We look forward to learn about the progress on the implementation of these measures in the context of the upcoming program reviews.

On financial sector policy, we take positive note of the progress made by the authorities to strengthen banking supervisory and regulatory framework, including the steady move toward a risk-based supervision. In view of the central bank limited capacity to act as a lender of last resort in the context of a euroized economy, the program rightly seeks to build on this progress in collaboration with Fund staff to further strengthen the emergency liquidity assistance framework in line with international standards and to fully adopt risk-based supervision by early 2016. We are also encouraged that initiatives to address structural bottlenecks to bank lending will be monitored under the program and we look forward to the outcomes of staff's planned comprehensive diagnostic of this issue in the coming months.

Finally on structural reforms, we concur that fiscal reforms should be an integral part of the authorities' reform package to improve the business environment and boost external competitiveness in view of the central role of fiscal policy in Kosovo. In this context, we welcome the reforms envisaged under the program to improve public procurement practices and introduce formula to link public sector wages to productivity trends. We also welcome the modification of the investment clause of the fiscal rule to allow for more flexibility for funding critical development spending subject to the safeguards outlined in the staff report to ensure prudent use of this flexibility and preserve debt sustainability.

With these remarks, we wish the Kosovar authorities well in their endeavors.

Ms. Tangcharoenmonkong, Mr. Nguyen and Mrs. Waqabaca submitted the following statement:

Despite its relatively higher average growth performance than countries in the Western Balkans in recent years, Kosovo still faces significant challenges, including a large infrastructure gap, high unemployment and low per capita income. A shift of its growth drivers towards more investment and the tradable sector is needed to lift medium-term prospects and improved social and macroeconomic performance. The current favorable political setting provides a timely opportunity to put in place policies and reforms necessary to safeguard fiscal and debt sustainability and preserve financial stability while improving the conditions for more resilient growth. We lend our support to the request for a 22-month Stand-By Arrangement (SBA) which would support the authorities' continuing efforts to strengthen the macroeconomic framework and accelerate the implementation of reforms. We thank staff for a well written report and Mr. Çanakci and Mr. Mehmedi for their helpful buff statement.

Growth-friendly fiscal consolidation is appropriate given the need to create fiscal space and boost growth. We note the authorities' commitment to prioritize fiscal adjustments aimed at strengthening public finances, reducing current expenditures and improving the composition of the budget. The implementation of planned public sector wage reforms and amendment to the investment clause of the fiscal rule are critical in this regard. Reducing the relatively high labor costs and aligning wages to productivity while narrowing the large infrastructure gap, are essential to improving the country's competitiveness and unlocking the economy's growth potential. Nevertheless, given the social pressures that can potentially arise from these reforms, careful risk management and an effective communication strategy are needed to ensure broad support for the authorities' National Economic Reform Program (ERP) 2015–2018 and achievement of program targets. Ensuring credibility in the implementation of the Medium-Term Expenditure Framework (2016–18) will be important to ensure that near-term fiscal measures are aligned with medium-term fiscal and debt sustainability objectives and in compliance with the fiscal rule.

Improving the resilience and supportive role of the financial sector in the economy is essential. Despite the overall soundness and stability of the financial system, credit penetration remains low and gaps prevail in the liquidity as well as regulatory and supervisory framework, limiting the financial sector's contribution to growth. As such, setting structural benchmarks to strengthen the ELA framework and fully adopting a risk-based supervisory framework are appropriate. Importantly, removing the legal and structural impediments to debt and insolvency resolution processes and credit provision while improving the business environment, will encourage greater private sector participation in the economy. We see an important role in the Fund's continued assistance to further strengthen the macroprudential framework, financial safety net, crisis preparedness and crisis management. We particularly encourage measures that will boost the financial sector's support for SMEs.

The implementation of structural reforms is key to unlocking the new growth model driven by investment and the tradable sector. It is therefore important to improve private sector productivity and competitiveness. Success in the Fund-supported program will help reinforce the implementation of the authorities' ERP 2015 to boost growth and job-creation. Reforms to improve skills training and raise female labor participation are vital to increasing employment. We welcome the upgrading of the education curricula to address market needs and reduce skills mismatch as stated in the buff. Revamping the vocational educational system, in particular, will also help address this issue. We are encouraged to see coordination efforts among relevant ministries. Active dialogue with international partners is also important as their support remains critical in providing the much needed investments in key sectors of the economy.

With these remarks, we wish the authorities success in their economic reform endeavors.

Mr. Hiroshima and Mr. Shoji submitted the following statement:

We welcome the recent Kosovo's resilient economic growth and financial stability. Meanwhile, the country has limited capacity deriving from insufficient industrial base and weak competitiveness that constrain the medium-term growth potential. This said, given the authorities' strong commitment to reform-agenda as mentioned in Mr. Çanakci and Mr. Mehmedi's statement, which will pave the way for a higher economic growth, we support the request for a Stand-By Arrangement (SBA).

As we broadly agree with the thrust of the staff appraisal, we will limit our comments to the following points:

Fiscal Policy and Structural Reforms

We share the staff's view in the sense that fiscal discipline is a key to build up the credibility of the program. In this context, we commend that a 2015 revised mid-year budget includes significant measures to decrease the deficit. The approval of the revised budget prior to the program will be strongly encouraged. We further urge the authorities to make adjustments in improving the budget composition and improve the government's bank balances that are under prudent levels. Especially, the higher wage of public sector will make it difficult for private sector to retain talented workers and will remain as weakened industries' competitiveness, and therefore, the introduction of a public wage bill will be a key step. On the other hand, the authorities need to allocate sufficient budget resources to the infrastructure investment which will stimulate the short-term economic growth and help improve the business environment in the long term while preserving debt sustainability. In this regard, we appraise the authorities' intention to accommodate flexibility in the fiscal rule setting that allow donor-financed capital projects to exceed over 2 percent deficit ceiling. We also note the importance that a set of reforms to address corruption will matter in order to facilitate infrastructure projects.

Financial Sector

We welcome that the financial sector in Kosovo is generally sound and banks are well capitalized and bank's NPL ratio is manageable. However, Kosovo's credit penetration is lowest in the Western Balkans while credit demand seems low reflecting the economy which highly depends on remittances without fostering domestic industries. When a set of reforms are materialized, we expect that money demand from the private sector will increase for starting businesses. From this viewpoint, how do staff assess the banking sector's capability such as credit evaluation to accommodate money demand from emerging domestic industry? Are there any potential risks of instability in the financial systems as a result of accelerating financial depth? Comments are welcome.

Mr. Dupont and Mr. Hough submitted the following statement:

We thank staff for their comprehensive report and Messrs. Çanakci and Mehmedi for their helpful buff statement. We can agree to the request for a new SBA program which should help Kosovo meet the dual objectives of strengthening macroeconomic stability and implementing structural reforms that lessen dependence on a remittance-led economic model. It is important that the authorities remain committed to the program objectives and do not pursue policies that undermine fiscal discipline, as they did upon expiry of the last SBA in the run-up to elections.

Preserving fiscal sustainability and rebuilding buffers are key objectives. The recent increase in public sector spending has worsened fiscal sustainability and reduced the space for productive investment spending. The program's focus on freezing public pay levels and limiting current spending is appropriate. We encourage the authorities and staff to develop an appropriate macroeconomic anchor for guiding public sector wages. The emphasis on amending the fiscal rules to preserve capital expenditure, thus enabling donor-financed projects to proceed, is also sensible. Finally, we agree that restoring government bank balances, to the 4.5 percent of GDP level considered as prudent, is vital as it acts as an important buffer in the fully-euroized Kosovar economy.

The authorities should build upon progress made in ensuring financial stability. Improving the Emergency Liquidity Assistance (ELA) framework, the macroprudential policy toolkit and crisis management, in line with best practice, to provide greater transparency and certainty is vital in a financial system where the central bank has limited capacity to act as a lender of last resort. Addressing obstacles to lending, such as difficulties collecting debt, is also important to reduce lending costs and ensure that the banking sector better supports the real economy.

We agree with staff that Kosovo's economic model will need to change from a remittance/consumption-led model to one led by investment and the tradable sector.

Remittances contribute to an unbalanced economy, with a very large trade deficit, reservation wages higher than domestic productivity can sustain, and investment directed mainly to the non-tradable sector. We support staff's proposals to improve the business environment, reform the procurement process to reduce corruption and control public sector wages to improve private sector competitiveness. We are also encouraged to note from the buff that the authorities acknowledge the need to change their growth model; in particular we note their plans to upgrade the education system and revamp their vocational training system. Can staff elaborate on what sectors of the economy offer the most potential for export growth?

Mr. Yambaye and Mr. Nguema-Affane submitted the following statement:

The last Board meeting on Kosovo in May 2015 clearly stressed the need for implementing economic and financial reforms in order to enhance competitiveness and safeguard macro-fiscal stability with a view to improving medium-term growth prospects and reducing unemployment. The authorities' initial actions in that regard were noteworthy at that time and given the additional actions taken since then, notably the adoption of a revised budget, we support the authorities' request for a Fund arrangement to support their National Economic Reform Program 2015 (NERP) aimed at lifting Kosovo's growth potential and creating jobs, as indicated in the authorities' LOI.

A successful implementation of the fiscal program will be essential to restore credibility in the fiscal rule which limits fiscal deficit to 2 percent of GDP. We welcome the revised budget for 2015 which envisages additional adjustment through both revenue-enhancing and expenditures-reducing measures while preserving public investment, in line with the MTEF. We note the authorities' intention to further improve the composition of expenditures beyond 2015 in order to restore the government bank balances and preserve debt sustainability. We welcome the focus on containing the wage bill through a wage freeze and the approval of a public wage rule that will govern future wage increases. In light of the large infrastructure needs, we support the plan to modify the investment clause in the fiscal rule in order to allow for IFI-financed growth-enhancing projects, and to further improve the public procurement process.

We note the authorities' intention to make further strides in improving the financial sector's regulatory and supervisory framework, through further enhancing banking supervision and strengthening the financial safety net, crisis preparedness, and crisis management. We find the emphasis placed on adopting a risk-based supervision, enhancing collaboration for crossborder supervision and strengthening the ELA framework appropriate in that regard. We agree that significant efforts should be made to lift impediments to a greater contribution of the financial sector to the private sector. We note the actions envisioned in that regard, notably in the judicial system, as indicated by Mr. Çanakci and Mr. Mehmedi in their statement.

Additional structural reforms to improve the business climate, increase the country's competitiveness and support private sector development are clearly needed to benefit from the recently adopted Stabilization and Association Agreement between Kosovo and the EU, and transition towards an investment- and export-driven economy. We note the actions underway or envisaged in this regard, notably to upgrade the energy infrastructure, and reform the labor market and education system, as elaborated in Mr. Çanakci and Mr. Mehmedi's statement. We welcome the reactivation of the National Council on Economic Development to coordinate the reform efforts.

With these remarks, we wish the Kosovar authorities success in their reform endeavors.

Mr. Hurtado submitted the following statement:

We appreciate the staff's comprehensive report as well as the helpful and informative buff statement by Messrs. Çanakci and Mehmedi.

We take note of the need to adopt a credible and solid fiscal stance which should lead to debt sustainability, and we recognize the challenge of doing so by changing the composition of public spending from current expenditure to much-needed public investment in infrastructure.

We support the approval of the Stand-By Arrangement for the Republic of Kosovo under the conditions included in the proposed decision.

One of the characteristics of the labor market, according to last May's Article IV review, is that productivity is low relative to wages, or that unit labor costs are high. We would like to ask staff about the measures contemplated by the program to alleviate this beyond wage moderation.

Despite increasing bank profitability, it is stated that the correction of structural obstacles to bank lending—inefficient court processes, difficult collection procedures, etc.—is critical to support healthy bank activity. To what extent is success in these areas dependent on Legislature decisions? The staff's comments on this will be appreciated.

There is a significant risk in implementing the fiscal adjustment related to politics (paragraph 31). Could staff please comment on possible mitigation factors?

Finally, the current account deficit, which is quite substantial, is financed in good part by errors and omissions for 2014-15, and the latter remains important in the subsequent years (Table 1). To the extent that remittances are already part of the current account, what explains the persistence of high levels of positive errors and omissions in the projections?

We wish the authorities success in their future endeavors.

Mr. Meyer and Ms. Handt submitted the following statement:

We thank staff for its thorough analysis of the situation in Kosovo and broadly agree with the policy recommendation given. We also thank Mr. Çanakci and Mr. Mehmedi for their helpful buff statement. It appears that the policy decisions taken in 2014 led to generous government commitments regarding public wages, pensions and other benefits at the expense of urgently needed capital spending. Against this backdrop, the difficulty in observing the country's fiscal rule in 2015 and the sharp reduction in the government's bank balances at the central bank do not come as a surprise. We appreciate the safeguards embedded in the program in order to protect fiscal sustainability as well as the structural component of the program which strikes us as meaningful and well-focused.

Against this background, we agree to the program request and highlight the importance of the authorities' long-lasting commitment to prudent fiscal policies, which is of high importance in a euroized economy.

While the fiscal consolidation effort in 2015, which staff estimates to be close to 3 percent of GDP, sounds rather large, we recall that this effort will mainly serve to prevent a significant deterioration of the fiscal balance which was induced by the authorities' policy decisions in 2014. We therefore would have preferred a greater adjustment effort in 2016 and 2017 in order to achieve a better balance between IMF financing and macroeconomic adjustment. Likewise, we would have preferred a more gradual build-up of the government's bank balance that would have led to a more evenly phased disbursement schedule.

In any case, we encourage the authorities to put every effort into the full implementation of the envisaged fiscal measures in 2015 and the identification of additional measures to achieve the fiscal targets in 2016 and beyond. We particularly stress the need for a successful reduction of the current spending in order to put public finances on a sustainable base. The timely introduction of a prudent public wage rule that should aim at gradually reducing the positive gap between public and private wages appears to be of the essence in this respect.

We take note of the planned modification of the fiscal rule—excluding new donor-financed capital projects from the calculation of the excessive deficit. While recognizing the need for higher capital spending, the projected deterioration of the overall fiscal balance and the increase in the public debt to GDP ratio over the program horizon could send ambivalent signals concerning Kosovo's fiscal policy stance at a time when strengthening fiscal credibility is crucial. In this context, we wonder what happened to the authorities' plans to privatize the Post and Telecommunication Kosovo (PTK), which was envisaged to generate proceeds around 5 percent of GDP. The staff's comments are welcome.

Given the need to spur private sector activity in Kosovo, we appreciate the program's emphasis on improving public sector governance and removing structural impediments to bank lending in order to improve the business climate. At the same time, staff's estimation of a rather high price competitiveness gap illustrates the importance to reduce real labour costs. In this context, we are reassured that staff views the funding risks for the high and rising current account deficit in Kosovo's euroized economy to be manageable. Based on the need for large-scale infrastructure investments, especially in the energy and transport sectors, we welcome that the program will catalyze additional donor-project financing.

Mr. Daïri and Mr. Badsi submitted the following statement:

We thank staff for the well written report and Mr. Çanakci and Mr. Mehmedi for their informative statement.

Kosovo has enjoyed resilient economic growth, attributed in part to strong remittance inflows, which have also helped to smooth consumption. However, the heavy reliance on remittances has pushed wages beyond the equilibrium level, which has been costly in terms of high unemployment rates and loss of external competitiveness. We are encouraged that the authorities' program for which they are requesting Fund support will prioritize policies to tackle high labor costs, strengthen public finances through fiscal consolidation, remove structural impediments to bank lending, and improve the business environment. We concur with the staff appraisal and support the authorities' request for Fund support under a Stand-by Arrangement.

The authorities should be commended for the measures taken to reduce the deficit and improve budget composition by containing current expenditures, notably the wage bill and spending on goods and services, while protecting investment spending. These measures, together with the revenue-enhancing measures such as the increase in the VAT rate and additional excise taxes, will help contain the budget deficit within the bounds of the fiscal rule. Looking ahead, the authorities are appropriately focusing on addressing the gap between public and private sector wages, which will be vital in boosting competitiveness and creating space for pro-growth priority expenditures. In light of the well-known difficulties in measuring labor productivity in the public sector, we would welcome staff comment on the rule that will be introduced this year for linking growth in the public sector wage bill to an easily-monitorable macroeconomic indicator. Are the authorities planning to use a composite indicator, and what are the components of this indicator? Regarding capital expenditures, we agree with the modification of the investment clause in the fiscal rule, which will allow additional targeted and much-needed infrastructure spending in high-priority areas.

We welcome the focus on strengthening the financial safety net, especially the envisaged new framework for emergency liquidity assistance (ELA). We agree that a strong ELA framework is critical for the euroized economy, and would welcome staff comments on the broad contours of the envisaged framework, including enhancing the central bank's capacity to act as a lender of last resort for Kosovo's banks. The authorities are encouraged to continue improving the regulatory and supervisory framework, and we look forward to the full adoption of risk-based supervision. We agree that for the banking sector to play its role in supporting economic growth, structural obstacles to bank lending should be removed. The authorities are encouraged in particular to take additional steps to enhance the efficiency of court processes and debt collection procedures. While the introduction of the general procurement law in line with international best practice is in the right direction, we look forward to further reforms to the public procurement process as planned.

Mr. Choi and Mr. Remengesau submitted the following statement:

We thank staff for their excellent report and Mr. Çanakci and Mr. Mehmedi for their informative buff statement. We broadly agree with staff's assessment of the current economic development of Kosovo and support Kosovo's request for Fund support under a Stand-By Arrangement.

Adopting a credible and solid fiscal stance should lead to debt sustainability. We agree with staff that fiscal consolidation is strongly needed to bring back confidence and safeguard a sustainable debt position. We therefore encourage the authorities to keep the fiscal deficit below 2 percent in the medium term. In order to meet this target, we stress the importance of broadening the tax base and improving tax collection efforts. We also agree that low public debt could help Kosovo secure external funding to finance budget deficit. In particular, we would like to emphasize the importance of freezing public sector wage bills and limiting current spending. We welcome the focus on containing the wage bill through a wage freeze and the approval of a public wage rule that will govern future wage increases. Given the large infrastructure needs, we also support modification of the investment clause in the fiscal rule to allow for IFI-financed growth-enhancing projects and to further improve the public procurement process.

We welcome the positive progress in the financial sector to strengthen banking supervision and regulatory framework. We highly encourage staff to strengthen the capacity of the central bank through strengthening the emergency liquidity assistance framework to provide greater transparency and certainty. Addressing structural bottlenecks to bank lending will help support private sector investments.

We agree with staff that, given Kosovo's heavy reliance on remittance, more efforts to develop the investment and tradable sector-led economy are necessary. In this regard, we support staff's proposal to improve the business environment and reform the procurement process to reduce corruption. As indicated by the buff statement, we would like to highlight the importance of enhancing the quality of the education system and revamping the vocational training system to make it responsive to the market needs and reduce skills mismatch.

Mr. Guyon submitted the following statement:

We thank staff for a well-written report and Mr. Çanakci 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.

Mr. Fachada abstained from the decision.

Mr. Raj abstained from the decision.

The staff representative from the European Department (Mr. Miniane), in response to questions and comments from Executive Directors, made the following statement:[1]

> I thank Directors for their thoughtful gray statements and for supporting the decision.
>
> I want to confirm that the authorities have met the prior actions. They have passed the budget fully in line with program targets, and the supporting measures—notably the VAT and excises—have also been passed in line with program discussions.
>
> We have circulated written answers to Directors' technical questions. I would like to address a few policy-related questions that were raised by Directors.
>
> Several Directors asked about the wage rule. We do not yet have the formal shape, content and indicators of this rule. This is a structural benchmark for the second review, so discussions are ongoing with the authorities.
>
> As many Directors noted, ideally the wage rule would be based on a measure of public sector labor productivity, but this does not exist in Kosovo. Even aggregate productivity measures in Kosovo are scant. Because of this, we are looking at a few indicators, for example nominal GDP growth, which would measure both inflation and real growth. We are also looking at the gap between private and public sector wages because that would also be an important indicator of competitiveness.
>
> Neither of these would be perfect or ideal, but any rule would be better than the out-of-control pre-electoral discretion we have seen in the previous two cycles, and which has done so much harm to competitiveness. But we just do not have the rule at this stage.
>
> Regarding when the rule is expected to kick in, our expectation is that at the very least, wages will continue to be frozen in nominal terms in 2016, as they are now. The rule will not kick in for the 2016 budget. As for the implications of the rule on wages and salaries in the 2017 budget, we will assess that at the time of the budget discussions for 2017, which will take place a year and a half from now.

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[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Some Directors asked about program risks, in particular a shift in political appetite for keeping wages and benefits frozen. That is a very valid point. In the previous program, we had a similar pattern of large pre-electoral wage increases and then wage freezes throughout the program, and those were achieved with some political opposition, but it was not insurmountable, so we hope that the same pattern will prevail this time. We will remain attuned to these political risks and implementation risks, and we will keep Directors informed in a timely manner.

There was a question on the pace of fiscal consolidation. Fiscal consolidation in the program is substantial. There was already consolidation in the 2015 budget. There was consolidation right after the Article IV consultation, and now there is additional consolidation in the mid-year budget. In the mid-year budget, there is close to 3 percent of GDP consolidation in annualized terms. Next year, there is an additional 1 percent of GDP or less in consolidation. This is significant for a country with debt that is substantially less than 20 percent of GDP. In addition, and separately, bank balances in a euroized economy are a key component of international reserves, so we believe it is important that they return to prudent levels quickly, otherwise the country would remain vulnerable. The combination of frontloaded fiscal adjustment and frontloaded Fund disbursement that the staff proposes best meets these two conflicting objectives—what is fiscally feasible and desirable, and bringing balances back to prudent levels as quickly as possible.

Finally, regarding the pace of debt accumulation in the program, it is true that debt is increasing, but it is increasing substantially less than in the passive Article IV baseline. Moreover, a significant chunk of this debt accumulation is financing capital projects that the country needs, unlike in the Article IV, where the debt accumulation was financing unproductive current spending. Some of the debt accumulation is financing increasing international reserves. There are also debt limits in the program, in the investment clause. We believe debt accumulation in the program makes good use of available fiscal space, because debt is low, and notwithstanding the fact that much of this debt accumulation is donor-financed at long maturities and at advantageous interest rates.

Mr. Çanakci made the following concluding statement:

I thank Directors for broadly supporting the approval of a 22-month Stand-By Arrangement (SBA) for Kosovo. This SBA will build upon the progress achieved over the recent years, while further strengthening the macroeconomic framework and accelerating the implementation of structural reforms. The program will significantly contribute to the authorities' efforts to shift from the current remittances-based growth model to one that is increasingly driven by investment in the tradable sector. In turn, the program will greatly help generate broad-based economic growth and jobs.

In their gray statements, many Directors recommended durable fiscal adjustment to keep Kosovo within its fiscal rule and rebuild government bank balances. The Kosovo authorities attach utmost importance to maintaining macro fiscal stability and preserving the credibility of the fiscal rule. In this context, the fiscal adjustment is at the core of the program.

The revised budget for 2015, approved on July 16, incorporates both revenue-enhancing and expenditure-reducing measures in the amount of 1.5 percent of GDP.

In complex social circumstances, the authorities have increased the VAT rate and excise taxes on tobacco and gambling. They have also cut spending in transfers and goods and services, and have frozen the wage bill in nominal terms for both this year and next year.

Essentially, the program will also restore government bank balances, which serve as an important buffer in the fully euroized Kosovo economy, to adequate levels, which is 4.5 percent of GDP.

As noted and welcomed by many Directors, the wage rule will keep public sector wages in line with productivity dynamics and enhance the competitiveness of Kosovo's economy, while also preventing large discretionary increases in the public wage bill. I welcome that Directors broadly support the modification of the investment clause in the fiscal rule, which will allow for additional targeted and much needed infrastructure spending.

Given Kosovo's large infrastructure gap and social needs and a low level of public debt, which is only 10.4 percent of GDP, the international financial institution-financed projects aimed at priority sectors such as agriculture, infrastructure, health, will provide the desirable impetus for growth and job creation.

My authorities welcome Directors' recommendation to further shore up financial regulation and supervision. In fact, they plan to adopt the risk-based supervision for all banks, and put in place a new emergency liquidity assistance framework consistent with international standards.

As accurately noted by Mr. Hiroshima, Ms. Tangcharoenmonkong, Mr. Chodos, Mr. Yambaye, and Mr. Beblawi in their gray statements, credit penetration in Kosovo remains low at 35 percent of GDP, mainly due to structural problems, including lengthy and costly court proceedings, difficult debt collection procedures, and high interest rates spreads and collateral requirements. To better utilize the high levels of liquidity in the banking sector, several policy actions are being envisioned to tackle these binding constraints. Moreover, the comprehensive diagnostic of legal and structural impediments to credit provision will be undertaken by the staff in the coming months, and it will identify further areas warranting policy actions that will help alleviate the existing bottlenecks.

The Kosovo authorities remain committed and are working with the staff to further develop the macroprudential toolkit and strengthen the crisis management framework.

The authorities fully agree with Directors that fiscal and financial stability are essential but not sufficient for Kosovo to move to a growth model that is driven by investment and the tradable sector.

Therefore, the program envisages a realistic set of structural policy reforms that are aimed at expanding Kosovo’s productive and export capacity through tackling the country’s wage and nonwage competitiveness gap and improving the business environment.

Interventions are aimed at improving the oversight and the control of the public procurement process, which will improve governance, enhance the business environment, reduce skills mismatch, and ensure an adequate supply of energy.

Directors emphasized the importance of the authorities’ commitment and strong ownership of the program. I would like to underline that with a grand coalition in place, which enjoys a comfortable majority in the parliament, and with no general elections scheduled until 2018, there is strong political buy-in, ownership, and commitment to the program implementation, and reform agenda.

In conclusion, on behalf of my Kosovo authorities, I thank the staff and the mission chief, Mr. Miniane, for their excellent work and close collaboration with the authorities. The candid and frank approach shown by the whole team deserves praise and gratitude.

The following summing up was issued:

Executive Directors welcomed the authorities' commitment to the new program's priorities of supporting macrofinancial stability and increasing the country's growth prospects. Given Kosovo's euroized economy, they stressed the need for a durable fiscal adjustment to keep deficits within the fiscal rule, improve the composition of the budget, rebuild government bank balances to adequate levels, and further shore up financial regulation and supervision. Restoring robust and inclusive growth over the medium term will require sustained efforts to improve competitiveness and the business environment.

Directors supported the growth-friendly fiscal adjustment under the program, which will preserve fiscal credibility while creating space for high-quality investment. They welcomed the passage of the mid-year budget, and stressed the importance of sustaining efforts to improve budget composition by deflating unproductive current spending. Along with revenue-enhancing measures, this will be necessary to reach the program's fiscal targets and rebuild government bank balances to adequate levels. At the same time, noting Kosovo's relatively low debt and large development needs, Directors supported the authorities' plans to modify the fiscal rule's "investment clause" to create additional space for well-vetted, donor-financed capital projects. They underscored the need for strong oversight and monitoring of these projects to maximize their benefits, while preserving fiscal credibility and protecting debt sustainability.

Directors noted Kosovo's broadly sound banking sector, and agreed with the planned efforts to shore up regulation and supervision, and to help banks better support economic growth. Directors welcomed plans to adopt an emergency liquidity assistance regulation in line with international best practice and to fully roll out risk-based supervision to all banks. They also looked forward to the development of a macroprudential toolkit and the operationalization of the financial stability committee. Directors welcomed the authorities' request for a Fund technical diagnostic on potential legal and judicial impediments to credit provision, with an eye toward improving access to finance in a country where credit penetration remains low. They also supported further strengthening of the AML/CFT regime.

Directors stressed the need for measures to improve competitiveness and the business environment, and raise long-term growth and employment prospects. They agreed that plans to cap growth in the public sector wage bill relative to well-defined indicators should help tackle Kosovo's historical challenge of unrestrained public sector wage increases, which have undermined the private sector's efforts to attract and retain talent. Directors also welcomed reforms to the public procurement process that should lead to a more transparent business environment, and supported plans to improve the education system.

The Executive Board took the following decision, with two abstentions by Messrs. Fachada (BR) and Raj (IN):

Republic of Kosovo—Request for Stand-By Arrangement

1. The Republic of Kosovo has requested a Stand-By Arrangement in an amount equivalent to SDR 147.5 million for a period of 22 months from the effective date of this decision.

2. The Fund approves the Stand-By Arrangement for the Republic of Kosovo set forth in EBS/15/77 and decides that purchases may be made under the arrangement, on the condition that the information provided by the Republic of Kosovo on the implementation of the measure specified as a prior action in Table 2 of the Memorandum of Economic and Financial Policies attached to the letter from the Prime Minister, the Minister of Finance and the Governor of the National Bank of the Republic of Kosovo, dated July 6, 2015, is accurate.

3. The Fund waives the limitation in Article V, Section 3(b)(iii). (EBS/15/77, 7/10/15)

Decision No. 15842-(15/78), adopted
July 29, 2015

APPROVAL: April 15, 2016

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. ***We note that increases in investment this year and especially in 2016 will be much higher than those of consumption. Could the staff elaborate more on these changes of trends and projections?***

- Stronger 2015 investment growth projections are partly due to base effects: Investment growth was weak in 2014 amid an election and subsequent prolonged political uncertainty. Starting from a low base, investments that have been deferred to this year should mean improved investment growth. In addition, staff project strong investment growth in 2016/17 based on the recent agreement on the Brezovica ski resort—a development that had not yet materialized at the time of the Article IV discussions and which could amount to 8 percent of GDP in investment over 10 years. Finally, the numbers account for potential additional investment catalyzed by the expansion of the fiscal rule's investment clause.

Fiscal Policy

2. ***Could the staff remind us about Kosovo's tax evasion rate and informality? Have there been any changes in this regard over the past years?***

- There are a number of estimates on the size of the informal economy and the extent of underreporting of income. These estimates vary depending on the methodology applied and the data used (see table below). The most recent estimates are provided by the World Bank as part of the Kosovo Public Finance Review in 2014 using two alternative methodologies. Applying a macroeconomic currency demand-based approach yields estimates of the informal economy ranging from 8–19 percent of GDP. However, these estimates are likely to be downward biased for various reasons. According to an alternative microeconomic approach, the tax gap for VAT amounts to 34 percent of current revenue collections, which would imply that the informal economy is substantially larger. Based on these estimates, staff believes that it is realistic to assume that the size of the informal economy is around 30 percent of GDP.

- Program projections of the revenue yield of the VAT reform take into account tax evasion. With full tax compliance, the annualized revenue gain would be substantially larger compared to program assumptions; the latter are conservative and fully reflect the fact that the VAT gap is large and undermines any revenue gains from VAT rate increases.

Source	**Year of publication**	**Methodology**	**Estimate**
Republic of Kosovo Kosovo Public Finance Review, World Bank	2014	Vito Tanzi model based on currency demand	Size of informal economy between 8 and 19 percent of GDP
		Tax gap analysis	VAT gap of 34 percent of current revenue collections
Khwaja, Munawer S. and Indira Iyer, Revenue Potential, Tax Space and Tax Gap in ECA Countries: A Comparative Analysis, World Bank, Working Paper	2013	Macroeconomic estimation based on cross-country regressions	Size of informal economy around 39 percent of GDP
A Business Perspective on Informality in Kosovo, Ebert Stiftung (FES) Office in Prishtina; the Kosovo Foundation for Open Society (KFOS); and Riinvest Institute for Research and Development	2013	Survey among 600 companies in Kosovo, selected from the Tax Administration Kosovo (TAK) database	Business managers and owners believe that on average the businesses in their industry do not report 34.4 percent of their sales
Survey on the Extent and Prevention of the Illegal Economy and Money Laundering in Kosovo, EU project 05KOS01/03/03/001, (used by the National Strategy of the Republic of Kosovo for the Prevention of and the Fight Against Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes 2014–18)	2007	Macroeconomic estimation	Size of informal economy between 27 and 35 percent of GDP

3. ***Can the staff elaborate on the nature of the exemptions from the proposed VAT increases and the resulting foregone revenue?***

- The recent VAT reform entails a reduced rate for basic food items, including milk, eggs, and vegetables. The rate reduction for these items leads to an estimated annual revenue loss of around €21 million (0.4 percent of GDP) with a general VAT rate of 16 percent as under the previous regime. In addition, foregone revenue is projected at around EUR 5 million (0.1 percent of GDP), as the increase of the general rate to 18 percent is not applied to these items.

4. ***In light of the recent increase in subsidy spending, we would also appreciate the staff's view of the scope for reducing this expenditure item.***

- The program has substantial measures to contain subsidies and transfers. As part of the mid-year budget review, 2015 spending on transfers and subsidies has been cut by around 0.2 percent of GDP compared to a non-adjustment baseline. In addition, subsidies and transfers are expected to remain about constant in percent of GDP next year despite the delayed effect of yet another pre-electoral measure (special pensions to Trepca miners). Without these measures, subsidies and transfers would be about 0.4 percent of GDP higher.

5. ***We do not object to the front-loaded trajectory of consolidation, the absence of which would lead to a large breach in the fiscal rule, but note that despite a fiscal consolidation of 1.5 percent/GDP in 2015, staff forecasts a 0.5 percentage point increase in GDP growth. Are fiscal multipliers fairly low in Kosovo?***

- Fiscal multipliers are low in Kosovo and, as such, staff expects the authorities' fiscal consolidation to have limited negative impact on growth. This is due to the very high import component of consumption and investment—a decline in consumption/investment means a corresponding decline in imports and so limits any potential decline in overall growth. In addition, growth is accelerating in 2015 despite fiscal adjustment because of the full year effect of last year's wage increases as well as investments that had been delayed by the six-month political crisis in 2014. Going forward, the recently signed Brezovica ski resort project and new donor-financed projects will provide further spurs to growth amid continued fiscal adjustment.

6. ***We understand from the staff report that the government's bank balances will only return to 4.5 percent of GDP by the end of 2016, which means that only after 2016 the planned projects can be implemented. Could staff elaborate on how this affects the program objectives, as these investments are seen as priority spending?***

- Due to the seasonal nature of tax revenues and budget expenditure as well as lumpiness in budget financing throughout the year, government bank balances fluctuate significantly from month to month. As a result, even in years when the government's average bank balance was above 4.5 percent of GDP, there were months where the balance was below 4.5 percent. Therefore, the legal interpretation of the law is that the government's bank balance does not have to equal 4.5 percent of GDP each month, but that the authorities' budget policy and financing framework should be consistent with an end-period level of bank balances of 4.5 percent. Because the authorities' 2016 budget and financing plans are consistent with an increasing path to an average bank balance of 4.5 percent in that year, the investment clause can be triggered in 2016.

Financial Sector

7. ***We are pleased that the central bank has committed to adopt a new ELA framework consistent with international standards. How will ELA reserves be sourced/financed?***

- The central bank (CBK) currently holds ELA reserves of EUR 97 million. This is comprised of CBK capital (EUR 51 million) and the special reserve fund (SRF), a €46 million deposit from the Treasury governed and administered by the CBK. The staff's analysis in the last Article IV consultation shows that these ELA funds, combined with banks' own liquid assets, are sufficient to mitigate severe liquidity shocks.

8. ***How does the staff assess the banking sector's capability such as credit evaluation to accommodate money demand from emerging domestic industry? Are there any potential risks of instability in the financial system as a result of accelerating financial depth? Comments are welcome.***

- The staff views the banking sector's credit evaluation capacity as adequate. Most banks in Kosovo, representing 90 percent of system assets, are foreign owned, and bring with them significant knowledge and skills transfers that are helping to develop this capacity. Within banks' existing loan portfolio, Kosovo's banking system has a low and declining aggregate NPL ratio relative to its Western Balkan neighbors, which suggests adequate credit evaluation in recent years. Moreover, Fund-supported efforts in recent years to strengthen bank supervision should help to better ensure the CBK's ability to monitor credit evaluation practices.

- While accelerating credit growth always warrants close monitoring, risks of instability in Kosovo are low. Kosovo's banks are well capitalized, highly liquid, and profitable, with adequate asset quality and NPLs fully provisioned. Besides the aspects just mentioned with regard to credit evaluation, steps by the authorities to fully implement risk-based supervision (a structural benchmark under the program) and plans to further develop a macroprudential policy framework should help to further shore up financial stability.

9. ***Despite increasing bank profitability, it is stated that the correction of structural obstacles to bank lending—inefficient court processes, difficult collection procedures, etc.—is critical to support healthy bank activity. To what extent is***

success in these areas dependent on Legislature decisions? The staff's comments on this will be appreciated.

- Fund staff plans to undertake a technical diagnostic mission later this year to more fully explore these issues, at which point we will have a better sense of how much success in this area is dependent on the legislative process. Steps taken by the authorities so far have involved measures requiring both legislative involvement, such as refinements to the system of enforcement agents, a draft bankruptcy law, and initial steps on a strategy for property rights; and other measures that do not, such as the reorganization of the court system, work with USAID to reduce the courts' enforcement backlog, and improving training for judges and court staff.

10. ***We agree that a strong ELA framework is critical for the euroized economy, and would welcome staff comments on the broad contours of the envisaged framework, including enhancing the central bank's capacity to act as a lender of last resort for Kosovo's banks.***

- The new ELA regulation that will govern the conditions under which the CBK will engage in lending of last resort is currently being discussed between Fund and CBK staff. Following Fund advice, the authorities have recently improved the draft regulation to incorporate bank viability as a criterion for ELA, and they have added language to stress the forward-looking nature of their assessment of viability and solvency. At the same time, Fund and CBK staff are still discussing whether the current regulation accepts a broad enough range of appropriate collateral, among other things.

Structural Reforms and Competitiveness

11. ***Are there other policy measures that could reduce reservation wage levels?***

- Moving away from excessive dependence on remittances from the diaspora will help in reducing high reservation wages in Kosovo. One possible measure would be to mobilize diaspora funds via diaspora bonds—i.e., government bonds that target diaspora investors and use the proceeds to finance infrastructure or other projects that benefit their families and communities (e.g., hospitals, schools). This way, the large reservoir of diaspora good will would be channeled towards productive uses rather than its financing consumption, leisure, or investment in non-tradables. The authorities are considering diaspora bonds.

12. ***Does staff believe that the measures listed in the report are sufficient to restore competiveness and, if not, what else should be considered?***

- As mentioned in the report, the program incorporates various measures to improve competitiveness, such as public sector wage restraint, added space for crucial infrastructure, reform of public procurement, and removing structural obstacles to credit.

- Going forward, staff will remain alert to other structural reforms within the Fund's mandate and expertise that could contribute to greater competitiveness. For example, the program does not have specific measures to address growing energy vulnerabilities, yet energy is a key bottleneck to growth. In addition, while reform to public procurement is central, Kosovo needs broad-based improvements in its rule of law. Part of the reason the program does not at this stage include conditionality in these two areas is because other donors have been in the lead in these areas for many years.

13. ***Can staff elaborate on what sectors of the economy offer the most potential for export growth?***

- The World Bank Systematic country diagnostic (still in draft form) and the 2015 National Economic Reform Program identify a number of sectors with high potential for export growth, such as manufacturing (such as garment and furniture), mining (Kosovo has large reserves of various metals.), agriculture (including food processing), and services such as travel and tourism (not least linked to the rehabilitation of the Brezovica ski resort).

14. ***We wonder what happened to the authorities' plans to privatize the Post and Telecommunication Kosovo (PTK), which was envisaged to generate proceeds around 5 percent of GDP. The staff's comments are welcome.***

- The authorities' current strategy is to first restructure PTK and then privatize it in 2018. The authorities estimate that privatization will yield about 3 percent of GDP in revenues, and this is reflected in the staff report tables.

External Sector

15. ***To the extent that remittances are already part of the current account, what explains the persistence of high levels of positive errors and omissions in the projections?***

- Historical positive errors and omissions reflect under-recorded remittances and FDI inflows, which in turn reflect the large size of the informal economy in Kosovo. Going forward, errors and omissions are projected to decrease substantially, from 5 percent of GDP in 2014 to 1.6 percent of GDP in 2020, as measures to estimate unrecorded flows continue to improve.