GRAY/15/2471

July 27, 2015

Statement by Mr. Meyer and Ms. Handt on Republic of Kosovo
(Preliminary)
Executive Board Meeting
July 29, 2015

We thank staff for its thorough analysis of the situation in Kosovo and broadly agree with the policy recommendation given. We also thank Mr. Canakci 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 eurorized 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% of GDP. *Staffs 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 eurorized 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.