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July 27, 2015

**Statement by Mr. Dupont and Mr. Hough on Republic of Kosovo
(Preliminary)
Executive Board Meeting
July 29, 2015**

We thank staff for their comprehensive report and Messrs. Canakci 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?*