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GRAY/15/2411

July 27, 2015

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

We are pleased to see the stability and resilience exhibited by Republic of Kosovo during these past years. Looking at the future, Mr. Canakci 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. Canakci 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 exists”. *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.