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**Statement by Mr. Odonye, Mr. Sitima-wina, and Ms. Basutli on Republic of Kosovo
(Preliminary)
Executive Board Meeting
February 12, 2021**

We thank staff for the set of reports and Mr. Palotai for his informative Buff statement. We commend the Kosovar authorities for their prompt containment measures and accommodative fiscal and monetary policies within the “Mitigation and Recovery Package” (MRP), which moderated the first phase of the Covid-19 pandemic. These measures have supported the much needed health sector’s response to the pandemic and cushioned vulnerable households and firms. Nonetheless, the severity and multiple waves of the pandemic have exposed some pre-existing structural weaknesses. In welcoming the authorities’ commitment to accelerate implementation of structural reforms to address the weaknesses, once the pandemic abates, we broadly support the staff appraisal and emphasize the following:

Contingency planning remains critical in view of the uncertainty underpinning budget financing and the projected rebound in economic activity in 2021. As noted in the report, growth is largely premised on continued fiscal support and the roll out of vaccines while a pickup in diaspora-related tourism and strong remittances are expected to strengthen the current account balance. These assumptions and the still-large number of new COVID-19 cases coupled with political uncertainty remain key risks that call for close monitoring of economic developments to enable timely response.

The suspension of the fiscal rule to accommodate the implementation of support measures is warranted. It is also not surprising that fiscal revenues declined following the disruption in economic activity while spending increased to support mitigation and recovery measures. However, it is concerning that, despite these support measures, inequality will increase, exacerbated by the likely increase in the education gap arising from inadequate infrastructure for remote learning in many households. We also note that government interventions mainly focused on the formal sector while the impact of the pandemic is disproportionately large in high contact sectors where informality is prevalent. In acknowledging the need for timely delivery of support, we stress that mitigation and recovery measures should be well-designed,

transparent, and targeted to those most in need. In addition, the authorities should avoid premature withdrawal of support to vulnerable households and firms until the recovery is firm. Accordingly, a clear communication strategy that highlights the temporary nature of current bonuses and transfers remains appropriate.

Beyond the pandemic, fiscal policy will have to be anchored on a credible consolidation path with a focus on domestic revenue mobilization including a review of tax expenditures and strengthening of tax administration. More broadly, we urge the authorities to enhance public finance management (PFM) encompassing procurement, public investment management, a comprehensive approach to wage and compensation policies and, social security. In addition, the authorities should review the operations of publicly owned enterprises (POEs) and strengthen their oversight to minimize contingent liabilities that could jeopardize fiscal and debt sustainability. In this connection, we look forward to the authorities demonstrating their commitment to establishing and developing performance and quarterly risk assessments for high risk POEs as noted in Mr. Palotai's informative Buff statement.

Safeguarding financial sector stability is critical to supporting a durable recovery. The Central Bank of Kosovo (CBK) financial sector policies have notably cushioned income losses and enabled a steady flow of credit in the economy. Looking forward, the CBK should maintain adequate operational controls while working to strengthen the macroprudential policy function and its legal framework. That said, we are encouraged that banks are, on aggregate, adequately capitalized, and deposits and lending have continued to grow despite the pandemic. Notwithstanding the low non-performing loans (NPLs) and prudent provisioning, the CBK should remain vigilant, monitoring the build-up of risks as forbearance is lifted. At the same time, we see merit in flexibility to allow banks to use capital buffers so that they can continue to lend to viable firms. We also urge the authorities to make progress in implementing the FSAP recommendations.

Finally, we encourage the authorities to step up implementation of structural reforms including in investments to reduce human capital and infrastructure gaps and improving governance. Further, aligning Kosovo's institutional framework with that of the EU and enhancing efforts in overall international integration would promote competition.