April 27, 2012

The following item is a Letter of Intent of the government of the Republic of Kosovo, which describes the policies that the Republic of Kosovo intends to implement in the context of its request for financial support from the IMF. The document, which is the property of the Republic of Kosovo, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
Dear Ms. Lagarde:

1. Kosovo’s economy has continued to perform strongly, shielded from the financial crisis in the euro area by limited trade and financial linkages. However, large external imbalances persist, reflecting *inter alia* infrastructure bottlenecks that continue to stifle productivity and competitiveness. These shortcomings are tackled by the government’s program to improve Kosovo’s infrastructure, including the highway network, that we have pursued since Kosovo gained independence in 2008. The associated increase in government spending, in particular capital expenditures, caused the fiscal balance to record deficits in subsequent years. To contain and fund these deficits we adopted a strategy consisting of the following elements: (i) drawing down the government’s bank balances, while maintaining a prudent minimum level, (ii) exercising restraint on current and non-infrastructure capital spending, and (iii) privatizing the state telecommunications company (PTK).

2. In 2010, we requested a Stand-By Arrangement (SBA) from the IMF in support of our program, with a view to helping anchor fiscal policy during the period of increased infrastructure spending and facilitating donor support. An 18-month SBA was approved by the IMF Executive Board in July 2010. While almost all quantitative performance criteria for 2010 were met, large public sector wage increases in the context of the 2011 budget prevented the completion of reviews under the SBA. Hence, in June 2011 we initiated a Staff Monitored Program (SMP) through end-2011, to establish a track record of disciplined policy implementation. The SMP targeted steps toward restoring fiscal sustainability, improved fiscal planning and budgetary execution, and measures to strengthen the financial system’s resilience. Implementation of the SMP has been broadly satisfactory, with significant overperformance in particular regarding fiscal targets, resulting in an overall fiscal deficit in 2011 of 1.9 percent, compared to 5.0 percent originally inscribed into the 2011 budget. Important progress has also been made in the area of financial sector structural reforms.

3. Notwithstanding these efforts the government’s cash buffers have fallen further, reflecting primarily the fact that we have not yet completed the privatization of PTK, after
the privatization process had to be abandoned following the withdrawal of one out of two prequalified bidders. As a result of this unexpected temporary drop in foreign direct investment, at end-2011 government useable bank balance stood at €160 million, about half the level needed to insure adequately against possible fiscal and financial risks. Provided the financial transaction related to PTK privatization will not be closed by end-2012, bank balances would remain well below prudent levels also in 2012. In a fully euroized economy like ours, bank balances serve not only as a budgetary buffer, they are also required to provide emergency liquidity assistance to banks if needed, and fulfill a similar role to international reserves in an economy with an own currency. The financing need resulting from the shortfall in bank balances therefore corresponds conceptually to a balance-of-payments need in a non-euroized economy.

4. Based on the resulting financing need and our performance under the SMP, we request that the Fund support our program through a new Stand-By Arrangement of 20 months in the amount of SDR 90.968 million (154 percent of quota). The program is outlined below. Its key objective is to continue on the path to fiscal sustainability that we embarked on in 2011 and anchor fiscal policy in the long-term, complemented by structural fiscal reforms and steps to further strengthen the financial system’s stress resilience. We believe that the policies set forth in this letter are sufficient to achieve the objectives of our economic program, but we will take any further measures that may become necessary for this purpose as circumstances change. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained here, in accordance with the Fund’s policies on such consultation. Further, we will provide the Fund with such information as it requests on policy implementation and achievement of the program objectives. The understandings between us and IMF staff regarding performance criteria and structural measures described in this letter are further specified in the attached Technical Memorandum of Understanding.

5. The government and the Central Bank of Kosovo (CBK) authorize the IMF to publish this letter and the associated staff report.

I. MACROECONOMIC OUTLOOK

6. The economy is expected to experience only minor spillovers from the crisis in the euro area, in view of limited financial linkages and a small export base. Moreover, we expect remittances, FDI, and other non debt-creating flows from Kosovars living in Germany and Switzerland to remain stable, reflecting the solid economic and labor market conditions in these economies. Such inflows have been an important source of growth in recent years. Nevertheless, the euro area crisis renders the outlook unusually uncertain. As a result, the macroeconomic framework underpinning the program is based on purposely cautious assumptions, with a view to minimizing the risk of downward revisions during the program period.
a. *Real GDP growth* is forecast at 3.8 percent in 2012. We believe there is a possibility of a better outcome, given that thus far there are no significant indications of a slowing in private sector demand. Moreover, in 2013 GDP growth is expected to recover, in line with developments in the euro area.

b. *Consumer price inflation* is expected to be subdued at around 1 percent this year, reflecting expected developments in global commodities markets, even though possible tariff increases in the context of a revamped electricity regulation may partially offset cheaper imports.

c. *The current account deficit* is expected to narrow somewhat in 2012/13 reflecting weaker domestic demand, falling below 20 percent of GDP. FDI and other non debt-creating flows will remain major financing items. Over the medium term the external balance is expected to gradually improve due to import substitution.

II. **Fiscal Policy**

7. The program’s principal objective is to anchor fiscal policy by restoring a sustainable fiscal stance and maintaining an acceptable level of government bank balances. With no monetary policy, fiscal policy is the main tool to safeguard macroeconomic stability. Structural fiscal adjustment started under the SMP, we aim at completing the process by 2014. We estimate that further adjustment of 1½ percent of GDP in 2013/14 is needed to return to a sustainable underlying primary deficit that would stabilize public debt at a prudent level of at most 30 percent of GDP in the long term. As regards bank balances, buffers of about €300 million would be desirable to adequately insure against fiscal and financial risks—a reference value that will increase as the government enters debt markets and needs to ensure debt servicing capacity even in case of disruptions in market access. We aim at returning to a fully adequate level of bank balances during the course of 2013.

8. To ensure that fiscal policy remains on a sustainable track even after the program period, we plan to adopt a legally binding fiscal rule that would provide guidance to policymakers and the public about the sustainable budgetary balance. The rule should also take into account transient factors and Kosovo’s fiscal decentralization framework. We requested technical assistance from the IMF to help us develop a rule, aiming at enacting the rule no later than mid-2013.

9. Further, fiscal management and planning will continue to abide by the following principles:

a. any new law, amendment to laws or regulations that create benefits will grant only cash benefits, with no link to the minimum wage;

b. any such law, amendment to a law or regulation will be preceded by a thorough fiscal impact assessment covering a period of at least 5 years (continuous structural benchmark);
c. any such law, amendment to a law or regulation will include an article that explicitly allows cutting benefits in case of insufficient budgetary funds (continuous structural benchmark).

A. Fiscal Policy in 2012

10. The 2012 budget law passed by the Assembly in December 2011 foresees an overall deficit of 3.3 percent of GDP and contains structural adjustment of ¾ percent of GDP, through a mix of wage restraint, revenue measures, and energy sector reforms reducing the need of budgetary support for the sector. The largest financing item in the budget law is the privatization of PTK. However, the privatization process has only recently been re-launched with the appointment of a new transaction advisor, and at this stage it cannot be pre-judged whether the transaction will be closed in 2012 or at a later stage.

11. To partly compensate for the shortfall in bank balances that would result in case of closure after 2012, the additional measures specified below are being implemented. We estimate their total yield at €40 million:

a. **Revenues.** At least €10 million will be raised from the introduction of environmental taxes and excise fees that will be phased in during the second and third quarters of 2012. These measures are structural and in line with the recommendations of the IMF technical assistance mission on tax policy from November 2011.

b. **Expenditures.** We decided not to allocate €20 million from the 2012 budget, and issued a government decision in March specifying the corresponding expenditure categories (€10.1 million in goods and services, €7.5 million in non-highway capital spending, and 2.4 million subsidies; prior action).

c. **Dividend income.** We have revised upward the expected dividend from PTK for 2012 by €10 million to €45 million, reflecting higher expected profits as a result of a reduction in wage and benefit cost in PTK enacted earlier this year.

12. In January of this year, we issued for the first time 3-month government T-bills at an effective interest rate of 3.5 percent (annualized). We plan to raise €74 million by selling securities in 2012, mainly to banks and to the pillar II pension fund (KPST). Going forward, we would like to gradually increase the maturity of government paper and establish a yield curve. To this end, a modification of our debt management strategy may be required, for which we are considering requesting technical assistance. Further, we have passed a revised pension fund law in April 2012 that loosens the exposure limit of KPST to the government to 30 percent of assets but introduces an investment limit of 50 percent of previous-year inflows into KPST, with a view to protecting the integrity of KPST’s investment strategy (prior action).
B. Medium Term Spending Initiatives and Structural Fiscal Reforms

13. We will protect the integrity of our tax system, and share with the IMF staff any planned legislation or government directive that has implications for the current tax policy. Specifically, we will refrain from introducing tax holidays from corporate income tax, maintain the current VAT threshold level, and refrain from adding new exemptions or reduced rates to VAT. Further, we are planning a broad review of the mining industry’s contribution to tax revenue and requested technical assistance for a review of Kosovo’s mining tax regime from the IMF.

14. To continue strengthening domestic tax collection, we will develop a strategy to transform the large taxpayer unit into a center that offers the full range of tax administration functions, and design a taxpayer compliance management plan for 2013 that follows up on the plan developed in 2011, both with support of IMF technical assistance.

15. Several capital and social spending initiatives require careful preparation and execution to safeguard fiscal sustainability.

   a. Working groups are currently preparing the methodologies for fiscal impact assessments for benefits for war veterans and erstwhile political prisoners, in consultation with the World Bank. The impact assessments require, as a starting point, a thorough evaluation of the number of eligible beneficiaries, and a careful design of the type and level of benefits. Any draft legislation that may be produced by these working groups will be shared with the IMF staff prior to consideration by the government.

   b. Eligibility criteria for pensions of families, disabled, and early retirees will remain unchanged. In particular, proof of 15 years of contributions to the former pay-as-you-go pension system will remain a precondition for receiving the supplementary pension (currently €35 per month).

   c. We are in the process of preparing a reform of the health sector. The objective is to ultimately transfer the provisions of health services from the government to a health fund that is partly funded by a government grant and partly by premia. Once we move to enacting relevant legislation this would occur in a phased manner and in close consultation with IMF and World Bank staff, with strong safeguards in place to ensure the financial viability of the health fund.

   d. Efforts to advance civil service reform are ongoing. The required secondary legislation will be issued only once the fiscal implications of the reform are well understood. Prerequisites are a thorough evaluation of the number of civil servants, as well as introducing safeguards to address the risk of over-grading and overtime payments. As a first step, we plan to introduce a grading system and a unified salary structure, supported by technical assistance from the World Bank.
e. **Highway R7** to Albania requires careful financial management as the project nears completion in 2013, notably with regard to containing variation cost. We are evaluating various options for the design and financing of **Highway R6** to Macedonia, and will closely consult with IMF and World Bank staff prior to taking any decisions, including on how to integrate the project into a sustainable medium-term budgetary framework.

16. We are in the process of reforming the inter-governmental grants system, based on the recent technical assistance mission from the IMF. Starting with the first budget circular foreseen to be issued in May 2012, we will grant municipalities flexibility to shift own-source revenues among all economic categories except wages (structural benchmark for end-May), with the objective to eventually expand the flexibility to all budgetary allocations, including the general grant. Further, we are considering additional reforms, such as (i) amending the distribution formula for the general grant to municipalities by a factor for revenue capacity; (ii) incorporating the official census results (to be announced in September 2012) in a gradual manner; and (iii) reducing the general grant gradually while increasing minimum property tax rates, to provide stronger incentives for municipalities to collect own-source revenues.

17. We are upgrading our system to monitor payment obligations. The objective is to develop the capacity to monitor in real time all payments coming due, in order to assist planning of the Treasury’s cash flow and prevent any accumulation of domestic payment arrears. We have requested technical assistance from the IMF to identify weaknesses in our system of recording and monitoring of payment obligations and make recommendations on how to improve the situation. We are currently training staff in the use of an upgraded software to monitor accounts payable, a process we expect to be complete by the end of 2012.

**III. FINANCIAL SECTOR POLICIES**

18. Kosovo’s financial sector has remained stable and unaffected by turbulence in the euro area, reflecting solid economic activity and the fact that the banking system—while mostly foreign owned—is funded by retail deposits and therefore shielded from strains in funding conditions in the euro area. Further, most banks are liquid, profitable, and well capitalized, with modest rates of nonperforming loans (about 6 percent for the average of the banking system). Notwithstanding the soundness of the banking system, we are strengthening the central bank’s ability to support and intervene in the banking system in case of need.

19. The central bank’s capacity to provide emergency liquidity assistance (ELA) to banks is now near-complete, with a memorandum of understanding between the CBK, the Ministry of Finance, and the Assembly’s Committee for Budget and Finance governing the provision of ELA taking effect last year. The second purchase under the SBA, amounting to €46 million, is foreseen to be deposited in the special reserve fund (SRF) designated for
ELA. Prior to this purchase, we will introduce an amendment into the Law on Public Financial Management and Accountability that specifies that only the CBK can dispose over the funds in the SRF for ELA (structural benchmark for June 15).

20. The new Banking and Microfinance Law (BML) was adopted in April (prior action). The BML significantly improves the central bank’s ability to deal with problem banks while strengthening the regulatory framework in several areas, including bank governance and exposure to related parties and large borrowers. With the support of technical assistance from the IMF, we envisage completing the process of revising rules and regulations to fully implement the BML by end-July 2012.

21. The Deposit Insurance Law (DIL) will be revised to ensure consistency with the new BML. The revised DIL will allow purchase and assumption transactions and it will maintain the narrow mandate of the deposit insurance fund, which limits its involvement in bank resolution, given that the BML assigns this role largely to the CBK. Submission of the revised law to the Assembly is a structural benchmark for end-May 2012.

22. To further strengthen our supervision capacity, we will request IMF technical assistance on loan documentation and classification practices—an area where on-site audits have repeatedly encountered irregularities. We are also looking forward to Kosovo’s first assessment under the IMF’s Financial Sector Assessment Program (FSAP) to be conducted by the IMF’s Monetary and Capital Markets Department and the World Bank in the second half of 2012. We expect the FSAP mission to take stock of all relevant reforms of recent years and propose further improvements to our financial architecture.

23. We are moving ahead with the reforms of the insurance sector, for which the CBK is the regulator. We conducted a full assessment of the insurance core principles (ICP) with World Bank assistance. A new resident advisor, financed by the U.S. Treasury, will work with the Insurance Supervision Department of the CBK on (i) reviewing the statement of duties for the CBK’s insurance supervision department; (ii) reviewing prudential requirements (for current and future reports) as well as the legal framework; and (iii) implementing a new on-site supervision manual for life and non-life insurance, including implementation of key actions as recommended from a World Bank report.

24. In the context of the arrangement, the Central Bank of Kosovo will undergo an updated safeguards assessment in accordance with the IMF safeguards policy.

IV. COMPETITIVENESS AND STRUCTURAL REFORMS

25. To further strengthen the business environment, raise competitiveness, and foster the development of a tradable sector, we have prepared a package of twelve laws aiming at reducing costs of setting up businesses, unifying business registries, and simplifying the licensing system. Nine laws have been passed (including on business organization, cadastre, reporting and auditing, establishment of immovable property right registers, external trade,
management and control of state borders). The remaining three laws have been drafted, and are expected to be approved by the Assembly by mid-year.

26. To safeguard the labor market competitiveness and employability of women, a report on the implementation of the Labor Law with the emphasis on maternity leave provisions is complete. We will analyze the report and take legislative action as necessary.

27. Our energy sector reforms are advancing. Billings and collections of the energy company (KEK) have improved substantially. We have finalized a functional and staffing audit of KEK, and in March the KEK’s management and Board set a timeframe for the implementation of the audit’s recommendations and right size the company. These steps are reducing the need for the Treasury to transfer resources to KEK. Further, after years of preparation, KEK intends to privatize its distribution and supply division. Bids are scheduled to be submitted by end-April. An auction for the New Kosova project for generation and mining is scheduled for September. The resulting investment in energy generation is expected to increase supply and reliability of electricity and reduce pollution.

V. PROGRAM MONITORING

28. The program will be monitored by quantitative performance criteria, indicative targets, and structural benchmarks as defined in the Technical Memorandum of Understanding (TMU). Monitoring will be on a quarterly basis, although in 2012 the review schedule will be slightly amended to bring it in line with Kosovo’s budget preparation schedule. The quantitative performance criteria and indicative targets for end-April 2012, end-August 2012, and end-December 2012 are set out in Table 1. The prior actions and structural benchmarks of the program are set out in Table 2. The first review is expected to be completed after June 30, 2012, the second review to be completed after December 20, 2012, and the third review after February 28, 2013.

29. The Program Monitoring Committee (PMC)—composed of the Minister of Finance (head), the Director of the Treasury, the two Budget Directors, the two Deputy Governors of the CBK, the advisor to the Prime Minister, the head of the Macro Unit, a representative of the tax administration of Kosovo, the Director of Finance of the Ministry of Labor and Social Welfare, and a representative of the Ministry of Economic Development—will meet at least once a month to assess progress with implementation of the Fund supported program and consistency of all relevant policy initiatives with the program’s objectives (continuous structural benchmark). The IMF resident representative will attend the meetings as an observer. The Ministry of Finance will prepare minutes of these meetings and send them to the IMF resident representative no later than 5 business days after the each meeting.
Sincerely yours,

/s/
Hashim Thaçi
Prime Minister

/s/  
Bedri Hamza  
Minister of Finance

/s/  
Gani Gërguri  
Governor of Central Bank of the Republic of Kosovo
Table 1. Kosovo: Quantitative Performance Criteria and Indicative Targets, SBA 2012–13
(Millions of euros; flows cumulative from beginning of the year)

<table>
<thead>
<tr>
<th>Performance Criteria 1/</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Floor on the bank balance of the general government</td>
<td>166</td>
</tr>
<tr>
<td>Floor on the primary fiscal balance of the general government</td>
<td>-21</td>
</tr>
<tr>
<td>Ceiling on primary expenditures of the general government</td>
<td>400</td>
</tr>
<tr>
<td>Ceiling on the net contracting of nonconcessional debt by the general government 2/</td>
<td>150</td>
</tr>
<tr>
<td>Ceiling on guaranteeing nonconcessional debt by the general government 2/</td>
<td>0</td>
</tr>
<tr>
<td>Ceiling on the accumulation of external payments arrears of the general government 3/</td>
<td>0</td>
</tr>
</tbody>
</table>

Indicative Targets:

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ceiling on the stock of domestic payment arrears of the central government</td>
<td>0</td>
</tr>
<tr>
<td>Ceiling on the stock of domestic payment arrears of the general government</td>
<td>0</td>
</tr>
</tbody>
</table>

Memorandum items:

<table>
<thead>
<tr>
<th>Program assumptions</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repayment of policy loans extended to public corporations</td>
<td>...</td>
</tr>
<tr>
<td>Non-project grants</td>
<td>4</td>
</tr>
<tr>
<td>Budget support loans</td>
<td>0</td>
</tr>
<tr>
<td>Project grants</td>
<td>1</td>
</tr>
<tr>
<td>Project loans</td>
<td>0</td>
</tr>
</tbody>
</table>

Sources: Kosovo authorities; and IMF staff estimates and projections.
1/ The floors and ceilings are adjusted according to the Technical Memorandum of Understanding.
2/ Exemptions apply according to Technical Memorandum of Understanding.
3/ Continuous ceiling on the gross flow of new accumulation.
Table 2. Kosovo: Prior Actions and Structural Benchmarks, 2012—SBA

<table>
<thead>
<tr>
<th>Actions</th>
<th>Type</th>
<th>Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passage of the Pension Fund Law in a version that limits (i) exposure of the pillar II pension fund to the government to 30 percent of the fund’s assets and (ii) annual investments of the fund in government paper to 50 percent of inflows into the fund in the previous calendar year</td>
<td>Prior Action</td>
<td></td>
</tr>
<tr>
<td>Passage of the revised Banking and Microfinance Law in a version consistent with the recommendations of IMF technical assistance</td>
<td>Prior Action</td>
<td></td>
</tr>
<tr>
<td>Issuance of a government decision that specifies spending cuts of €20 million across expenditure categories relative to the approved 2012 budget</td>
<td>Prior Action</td>
<td></td>
</tr>
<tr>
<td>Publication of budget circulars for municipalities that contain no limits on spending allocations across non-wage categories</td>
<td>Structural benchmark</td>
<td>End-May 2012</td>
</tr>
<tr>
<td>Submission of a revised Deposit Insurance Fund Law to the assembly that is consistent with the new Banking and Microfinance Law</td>
<td>Structural benchmark</td>
<td>End-May 2012</td>
</tr>
<tr>
<td>Amendment of the Law on Public Financial Management and Accountability by a provision that specifies that only the CBK can dispose over the funds in the Special Reserves Fund designated for Emergency Liquidity Assistance</td>
<td>Structural benchmark</td>
<td>June 15, 2012</td>
</tr>
<tr>
<td>Submission of a 2013 budget consistent with the objectives of the program to the assembly</td>
<td>Structural benchmark</td>
<td>End-October 2012</td>
</tr>
<tr>
<td>Monthly meetings of the Program Monitoring Committee and transmission of the meetings’ minutes to the IMF Resident Representative</td>
<td>Structural benchmark</td>
<td>Continuous</td>
</tr>
<tr>
<td>Inclusion of a paragraph into all new benefit creating laws, amendment to laws or regulations that allows cutting cut benefits if budgetary funds are unavailable</td>
<td>Structural benchmark</td>
<td>Continuous</td>
</tr>
<tr>
<td>Fiscal impact assessments evaluating the budgetary impact of all new benefit creating laws, amendments to such laws or regulations over a period of at least 5 years</td>
<td>Structural benchmark</td>
<td>Continuous</td>
</tr>
</tbody>
</table>
1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Kosovo authorities and the IMF staff regarding the definition of quantitative performance criteria and indicative targets, and reporting requirements for the Stand-By Arrangement (“SBA”) requested in April 2012.

I. PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Coverage

2. For the purpose of this memorandum, the central government is composed of the Executive, the Legislative, and Judiciary branches of the Government, and any other public authorities except municipalities that receive direct budgetary appropriations. The general government includes the central government and municipalities. Both the central and the general government exclude publicly owned enterprises and socially owned enterprises.

3. Performance Criteria and Indicative Targets. The performance criteria, indicative targets, and their respective test dates are set in Table 1 of the Letter of Intent (LOI).

B. Bank Balances of the General Government

4. Bank balances are funds usable and readily available (i.e., liquid or marketable, and free of any pledges or encumbrances), held and controlled by the general government for the purposes of making payments and transfers. Bank balances include Undistributed Funds of the Government of Kosovo plus funds specifically reserved for policy purposes including emergency liquidity assistance but do not include the balance of unspent Own Source Revenues (OSR) carried forward, or funds encumbered or pledged as Donor Designated Funds and funds relative to on lending operations. Bank balances do not include investments made and managed by an outside Investment Manager assigned by the Minister pursuant to Kosovo’s Law on Public Financial Management Article 7.1.(iii). Bank balances may be held in the form of gold, holdings of foreign exchange and traveler’s checks, demand and short-term deposits at the Central Bank of the Republic of Kosovo (CBK), long-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities held directly by the general government. Bank balances at December 31, 2011, were € 159.986 million.

➢ The floor on the bank balance set in Table 1 will be raised by
5. **Reporting requirements.** A table on bank balances will be transmitted by the Treasury with a maximum delay of five weeks after the end of each month. In addition, the CBK will submit twice a month, with a delay of 1 day, the Report of Positions of Treasury Accounts. Within 45 days after each test date, the CBK will submit to the IMF the independent audit of the reconciliation of government accounts.

C. **Primary Expenditures of the General Government**

6. **Primary expenditures** are measured on a cash basis cumulatively from the beginning of the calendar year. Primary expenditures include current expenditures (wages and salaries, goods and services, subsidies and transfers, reserves), capital expenditures, and net lending. They do not include interest payments or receipts or expenditures designated by donors financed with grants (“donor designated grants”). Net lending comprises loans granted by the general government except that it does not include onlending such as funds borrowed from KfW, which is instead included as a domestic financing item (“below the line”). All expenditures and net lending financed with loans to be serviced by the general government are in the program’s concept of expenditures and net lending, even if the cash did not transit through the Treasury.

- The ceiling on primary expenditures set in Table 1 will be raised by the excess of project grants and loans relative to program assumptions.
- The ceiling on primary expenditures set in Table 1 will be lowered by:
  - the shortfall of project grants and loans relative to program assumptions.
  - the repayment of loans extended to public corporations in excess of program assumptions.

7. For the purposes of this memorandum, **proceeds of privatizations** will be understood to mean all monies received by the government from the sale of a publicly owned company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the sale of government nonfinancial assets and from the liquidation of the assets of the Privatization Agency of Kosovo (PAK). Proceeds of privatizations are not part of revenues. Instead, these are recorded as a domestic financing (Net acquisition of financial assets).

8. **Reporting requirements.** Data on the monthly execution, budget appropriations, and budget allocations of revenues and expenditures will be provided monthly no later than five weeks after the end of each month, including (i) government domestic revenue detailing by components direct taxes, indirect taxes, and nontax revenues; (ii) external budget support grants; (iii) primary recurrent expenditure, (iv) domestic and external interest payments and receipts, (v) capital expenditure detailing all those related to the construction of Route 7 and
including domestically and budget support financed capital expenditure and externally project financed capital expenditure; (vi) the gross payment and gross accumulation of domestic payments arrears; (vii) external loan receipts and principal payments; (viii) external arrears payments and accumulation; (ix) bank and nonbank financing; (x) privatization and receipts of the sales of nonfinancial assets; and (xi) any other revenue, expenditure, or financing not included above.

D. Primary Fiscal Balance of the General Government

9. **Primary fiscal balance** of the general government is defined as revenues and grants minus primary expenditures cumulatively since the beginning of the calendar year. Revenues do not include privatization receipts.

- The floor on the primary fiscal balance set in Table 1 will be lowered by the excess in project loans relative to program assumptions.
- The floor on the primary fiscal balance set in Table 1 will be raised by
  - the shortfall in project loans relative to program assumptions
  - the excess in budget grants relative to program assumptions.

E. Contracting and Guaranteeing Nonconcessional Debt by the General Government

10. **Nonconcessional debt** is defined as debt contracted or guaranteed by the general government with a grant element of less than 35 percent. The grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD need to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

11. The ceilings on contracting and on guaranteeing nonconcessional debt cover both domestic and external debt, but exclude purchases from the IMF and the sale of the SDR holdings allocated to Kosovo. Debt rescheduling and debt reorganization of debts contracted before the approval of the SBA are excluded from the limits on nonconcessional debt. The quantitative performance criteria apply not only to debt as defined below but also to
commitments contracted or guaranteed for which value has not been received. The contracting or guaranteeing nonconcessional debt by the general government will be assessed at each test date.

12. The government of Kosovo will consult with Fund staff before contracting or guaranteeing any new debts in circumstances where they are uncertain whether the instrument in question is covered under the quantitative performance criterion.

13. **Definition of debt.** The definition of debt is set out in Executive Board Decision No. 12274-(00/85), Paragraph 9, as amended on August 31, 2009 (Decision No. 14416-(09/91)):

“(a) For the purpose of this guideline, the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

“(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

“(ii) suppliers’ credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

“(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

“(b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.”
14. **Reporting requirements.** Details of all new debt taken or guaranteed, indicating terms of debt and creditors, will be provided on a quarterly basis within five weeks of the end of each quarter.

**F. Domestic Payments Arrears**

15. A domestic payment obligation to suppliers or creditors is deemed to be in **arrears** if: (a) goods and services have been received; (b) they have been certified to conform to the order of the contract; and (c) the obligation has remained unpaid for more than 60 days after the invoice was received. A payment obligation is defined to be domestic if the creditor is resident in Kosovo.

16. **Reporting requirements.** The Ministry of Finance will submit a monthly table with the stock of domestic payments arrears and not in arrears. The data are to be provided within five weeks after the end of the month.

**G. External Payments Arrears**

17. **External arrears** are defined as total external debt service obligations of the government that have not been paid by the time they are due (after the expiration of the relevant grace period). External arrears exclude external debt service obligations subject to ongoing good faith negotiations of debt-rescheduling agreements. A debt service obligation is defined to be external if the creditor is not resident in Kosovo.

18. **Reporting requirements.** The Ministry of Finance will inform the Fund staff immediately of any accumulation of external arrears. Data on (i) debt-service payments; and (ii) external arrears accumulation and payments will be transmitted on a quarterly basis by the Ministry of Finance within five weeks of the end of each quarter.

**II. Other Data Requirements**

19. The monthly monetary statistics (including balance sheets and monetary surveys) of the CBK, the consolidated commercial banks and revisions to historical data (if any) will be transmitted on a monthly basis with a maximum delay of five weeks.

20. Data on exports and imports, including volume and prices and compiled by the Statistical Office of Kosovo (SOK), will be transmitted on a quarterly basis within forty-five days after the end of each quarter.

21. A preliminary quarterly balance of payments, compiled by the CBK, will be forwarded within three months after the end of each quarter.
22. The table of Financial Soundness Indicators and the regulatory capital and liquidity ratios of individual banks will be transmitted by the CBK to the IMF on a monthly basis within six weeks after the end of each month.

30. A monthly report on the number of employees will be transmitted to the IMF by the Treasury Department of the Ministry of Finance within two weeks after the end of each month.