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Kosovo: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

Press Release:

[Press Release: IMF](#)

[Executive Board](#)

[Completes Fifth](#)

[Review Under the](#)

[SBA with Kosovo;](#)

[Approves €4.8](#)

[Million Disbursement](#)

December 20, 2013

December 5, 2013

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Republic of Kosovo: Letter of Intent

Pristina, December 5, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

Dear Ms. Lagarde:

As this is the final review under our Stand-By Arrangement (SBA), we would like to take stock of the progress made in advancing macro-financial stability in the past two years. Kosovo has restored a sustainable fiscal stance through a mix of structural expenditure savings—notably a significant reduction of subsidies to publicly owned enterprises, including the energy sector—and growth-friendly revenue increases—in particular tobacco excises and lignite royalties. We are on-track to bringing the government bank balance to an adequate level. A legally binding rules-based fiscal framework, enacted in July 2013, safeguards responsible fiscal policies going forward. We have improved the preparation and costing of spending initiatives, as well as the recording and monitoring of payment obligations. A new banking law, passed in 2012, enhances the supervisory and resolution powers of the central bank. The Special Reserve Fund (SRF) for Emergency Liquidity Assistance (ELA) was funded with a government deposit over which the central bank has exclusive control. As regards labor market policies, we have established a rules-based framework for setting minimum wage levels. Further, Kosovo's rank in the World Bank's *Doing Business* survey has improved by 40 positions in the past two years.

1. While we are pleased to bring this program to a successful conclusion, we plan to continue close cooperation with the IMF, and intend to discuss the possibility of a successor program in the first half of next year.
2. Kosovo's economy has continued to display considerable resilience in the face of external headwinds. While growth was modest in both 2012 and 2013, it still exceeded that of other economies in the region. The banking system continues to be well-capitalized and liquid. We remain vigilant to risks, including those that could emerge from a possible deterioration in economic conditions in Diaspora host countries and, consequently, a reduction in current and capital inflows. As such, we remain committed to disciplined fiscal management, an adequate level of the government bank balance, the further strengthening of the legal and regulatory framework for Kosovo's financial system, prudent financial supervision, and structural reforms to boost competitiveness.

3. Since the 4th review, implementation of our economic program has remained broadly consistent with commitments under the Stand-By Arrangement (SBA; Tables 1 and 2):

- All quantitative performance criteria for end-August were met. The primary fiscal balance was higher than programmed by €63 million, as a shortfall in customs revenue collection was overcompensated by over-performance of domestic tax collection and under-execution of spending, notably of the capital budget. The floor on government bank balance was exceeded by €90 million. Both the general government's primary expenditures and the net contracting of non-concessional debt remained below program ceilings.
- The indicative (zero) targets for domestic payment arrears of the central and general government were missed by small amounts, but corrective action is being taken.
- We have also made good progress on structural benchmarks:
 - (i) On August 30, the Minister of Labor issued an administrative instruction to establish a rules-based treatment for setting minimum wage levels consistent with ¶121 of the Letter of Intent (LOI) of June 28, 2013.
 - (ii) On October 31, we submitted the draft 2014 budget to the Assembly. The budget is consistent with the rules-based fiscal framework and most elements specified in ¶12 of the LOI of June 28, 2013. The exception is current spending, where the budget exceeds the ceiling specified in the June LOI by €12 million. The additional allocations reflect higher-than-expected current expenditures by municipalities (€3 million)—which is beyond the control of the central government--and of implementing Law No. 04/L199—with relates to strengthening to the public administration in northern municipalities.
 - (iii) The continuous structural benchmarks on monthly meetings of our Program Monitoring Committee, and on fiscal impact assessments evaluating the budgetary impact of all new benefit creating laws and amendments to such laws over a period of at least 5 years, were also met.
- On November 29, 2013, we issued a decision not to allocate €88 million relative to the 2013 mid-year budget review, with specification of non-allocation across expenditure categories as follows: €71 million on capital spending, €15 million on wages and salaries, and €2 million on goods and services—thus satisfying the corresponding prior action.

4. Based on this performance, we request completion of the fifth and final review under the Stand-By Arrangement. We will continue treating the Stand-By Arrangement as precautionary, and therefore intend not to draw the amount that we would be entitled to purchase with the completion of this review.

5. We believe that the policies set out in the letters of April 12, 2012, June 27, 2012, December 5, 2012, April 8, 2013, June 28, 2013 and in this letter are adequate for successful implementation of the program. However, the government stands ready to take additional measures as appropriate to

ensure achievement of the program's objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this letter or before the adoption of new measures that would deviate from the goals of the program, in accordance with the Fund's policies on such consultations, and provide IMF staff with the necessary information for program monitoring. The understandings between us and the IMF regarding program criteria and structural measures described in this letter are further specified in the Technical Memorandum of Understanding. In line with our commitment to transparency, we authorize the IMF to publish this letter and the associated staff report.

I. Macroeconomic Outlook

6. The macroeconomic framework underpinning our program is based on prudent assumptions, with a view to minimizing the risk of downward revisions during the period ahead.

- *Real GDP growth* is expected to recover to around 4 percent in 2014, consistent with projected developments in Diaspora host countries and other advanced economies. Both domestic demand and exports are expected to contribute to the recovery.
- Annual average *consumer price inflation* is expected to moderate to below 2 percent, in line with projected developments for global food and fuel prices.
- *The trade deficit* is estimated to gradually narrow from 35 percent in 2012 to about 30 percent of GDP in 2014, reflecting the recovery in exports, the substitution of imports with domestic production, and lower projected import prices. We expect the deficit to be financed by current transfers, FDI and other inflows, mostly from the Diaspora.

II. Fiscal Policy

a. The 2013 Budget

7. Budget implementation through October 2013 was broadly in line with our program, as lower-than-expected revenues were compensated by under-execution of spending.

1. *Revenue collection* through end-August was short of the original program projections by €52 million, owing to continued weakness in the collection of border taxes and the delayed receipt in mobile telecommunication licenses. The pattern continued in September and October, due in part to a disruption of trade with Macedonia. We are now projecting a revenue shortfall for the entire year of €45-50 million, which assumes that the 3G-licenses would be sold before end-year.
2. Execution of *expenditures* through end-August was lower than budgeted by about €115 million. The bulk was due to under-spending on the capital budget. Another €15 million in under-execution accumulated in September and October, partly due to delays in enacting the mid-year budget review.

8. At the time of the 4th review, we expected the sale of PTK (with a gross sales price of €277 million) to be settled in September. However, the process is not yet complete, as the assembly has still to approve the report on the PTK privatization process and the winning bidder has not yet signed the sales contract. While we expect that privatization will proceed before end-year, we do, as a precaution, not base fiscal policy in 2013 and 2014 any longer on the sale of PTK, and are taking compensating measures to achieve our fiscal objectives regardless.

- a. Compensating revenue and expenditure measures with expected savings of €24 million have already been taken in the context of the 4th review earlier this year (¶8 LOI June 28, 2013).
- b. On November 29, 2013, we issued a decision to not allocate spending of €88 million, in addition to the €11 million already covered in June, and in line with the corresponding prior action.
- c. We have increased tobacco excises effective October 1, 2013, and we have approved a second round of tobacco excise increases effective January 1, 2014.

b. The 2014 Budget

9. On October 31, we submitted the 2014 budget to the Assembly, in line with the corresponding end-October structural benchmark. Preparation of the 2014 budget was guided by the rules-based fiscal framework and the elements specified in ¶12 of the LOI for the 4th Review:

- a. The budget is anchored by a ceiling for the general government deficit of 2 percent of GDP (excluding PAK-related spending). Together with the targeted budgetary outcome for 2013 and the planned 2014 financing envelop, the 2014 budget is consistent with achieving an adequate end-2014 government bank balance.
- b. In this context, in the event that the revenue from the sale of mobile telecommunication licenses is received in 2014—instead of 2013 as currently projected—the 2014 mid-year budget review would use these receipts for additional spending only if this does not put achievement of an adequate end-2014 bank balance at risk.
- c. A deviation relative to the 4th review is an increase in the ceiling on current spending by €12 million, of which €3 million relate to higher-than-expected current expenditures by municipalities—which is beyond the control of the central government. Another €9 million are due to the cost of implementing Law No. 04/L199, which relates to strengthening to the public administration in northern municipalities (costs that were not known by the time of the 4th review).
- d. Within the current spending envelope, the budget accommodates a public sector wage bill of €483 million (excluding PAK). The wage bill accommodates (i) additional hiring, accounting for €13 million, which relates in part to strengthening the public administration in northern municipalities and the creation of new educational institutions, and (ii) higher salaries of €45 million. For the latter purpose, a contingency allocation at the Ministry of Finance includes both the cost for civil service reform (estimated at around €18 million) that

is expected to be implemented early in the year, and a public sector wage increase. In case the civil service reform is delayed beyond the first quarter, the corresponding amount foreseen for this purpose will be saved. The wage increase follows zero wage rounds in 2012 and 2013, and will cover both 2014 and 2015. We intend to make the wage increase effective no later than mid-year, in order to safeguard sustainability of the public sector wage bill also in 2015.

- e. The budget includes a contingency allocation of €15 million for benefits to former political prisoners and a pension for war veterans. These allocations will be executed only after full fiscal impact assessments have been finalized.
- f. The budget incorporates an allocation of €531 million for capital expenditures (including 10.6 million is capital subsidies), of which €135 million (for both construction and expropriation) are for the new highway R6 to Macedonia. While the allocation for non-highway capital spending of €386 million is high compared to previous budgets, we are confident that implementation capacity is sufficient to ensure successful execution.
- g. We plan net issuance of government paper for €120 million in 2014. At the same time, we will seek to increase the average maturity of government debt, including by issuing paper with a 2-year maturity.

c. Highway R6

10. We have received three proposals for construction of Highway R6. Some proposals are substantially below the cost we had planned for R6 originally. We will select the winning bid by end-year, guided by the need to ensure cost effectiveness and maximize the project's economic benefits for the country. In this process, we will consult closely with the World Bank representative who acts as observer in the R6 steering committee.

d. Other Fiscal Issues

11. Looking ahead, we are planning a review of the government's revenue structure, in view of changes in the structure of Kosovo's economy, notably the ongoing shift from imports to domestic production and upcoming free trade agreements. To this end, we seek to (i) investigate options to further enhance the effectiveness of tax and customs collection, (ii) explore ways to reduce the amount of informality in the economy, and (iii) explore the adequacy of the tax structure in view of recent and anticipated developments. To this end, we are considering requesting technical assistance (TA) from the IMF, as a follow-up to the tax policy TA mission from 2011.

12. We have continued to make progress with our action plan to improve the recording and monitoring of payment obligations. We have amended treasury rules to enforce the timely recording of payments, carried out a publicity campaign to inform stakeholders about these changes and their implications, and upgraded our IT system (LOI June 28, 2013, ¶14 and LOI April 8, 2013, ¶14). As a result, we have noticed that suppliers are now increasingly approaching the Treasury directly for the clearance of outstanding arrears. Next, the Auditor General (AG) will audit budget

organizations whose arrears have been cleared by the Treasury, and recommend sanctions as foreseen in the Law on Public Financial Management and Accountability.

III. Financial Sector Policies

13. We remain vigilant of banks' risks and committed to ensuring compliance with prudential rules. In July and August, the CBK conducted on-site inspections to check the adequacy of provisioning, compliance with limits on related lending, recently tightened capital adequacy rules, and the sources of capital. As of end-September, the banking system's aggregate capital adequacy ratio (CAR) was 16.4 percent (from 14.8 at end-April) and all banks were in compliance with minimum required CARs and the new regulation on related lending. Also the banking sector's liquidity is satisfactory. However, the leverage ratio (equity to assets) of one bank was slightly below the minimum of 7 percent, while another bank had a large exposure above prudential limits. We will ensure that these banks are in compliance before end-year. While non-performing loans have been increasing, they are adequately provisioned. Nonetheless, we will monitor developments closely, in particular in banks with limited capital buffers or large exposures, and in the context of developing risk-based supervision.

14. We have made progress in implementing key recommendations from the 2012 Financial System Stability Assessment. In particular, since the 4th review:

- a. a CBK macro-prudential advisory committee was established and is meeting on a regular basis;
- b. the CBK is developing an action plan to implement the recommendations of a recent IMF TA mission to further strengthen crisis preparedness and management arrangements, including by establishing a bank contribution for ELA (see below); and
- c. the government is reviewing the guarantee for a back-up facility (i.e., a stand-by credit line of €10 million from the EBRD) for the deposit insurance fund (DIFK), aiming at submitting the guarantee for approval by the Assembly by end-year. Establishing a pre-arranged borrowing facility is a condition under the agreement with the donors that provided part of DIFK's seed capital.

15. As regards the planned bank contribution to ELA, the CBK will, as a first step, review the systemic liquidity framework. This will include an assessment of the overall level and sources of systemic liquidity funds that are adequate and feasible given Kosovo's specific circumstances, and compare these to existing back-up facilities (notably the government deposit funded SRF for ELA). Further, the review will analyze the modalities for establishing a bank-financed contribution, including financial and macroeconomic implications and relevant legal aspects. We aim to complete the assessment by end-March 2014. We will request IMF technical assistance to support this endeavor.

16. We remain committed to further progress with other FSAP recommendations, and plan the following next actions:

- a. The CBK will draft amendments to the ELA regulation and establish a working group to develop operational procedures for providing ELA to solvent banks during the first quarter of 2014. It will also draft a regulation and procedures for bank resolution (supported by forthcoming TA).
- b. The Financial Stability Committee, led by the CBK, will establish a working group charged with drafting a contingency plan to deal with systemic banking crises by end-April 2014.
- c. The CBK will receive IMF TA on risk-based supervision, macro modeling, and stress testing to further strengthen micro- and macro-prudential surveillance capacity and processes.

IV. Competitiveness and Structural Reforms

17. We have issued an administrative instruction for a rules-based framework for setting minimum wages, in line with the corresponding end-August structural benchmark (¶121, LOI, June 28 2013). We expect to generate the final figures for potential minimum wage changes in 2014 by end-December.

18. We are making progress with implementing our SME development strategy; specifically on two projects aimed at improving SMEs' access to finance and enhancing their international competitiveness. The first project—supported by the Swiss Corporation—supports SMEs' business needs through a voucher counseling scheme, which is now operational, and, in addition, will provide for their financing needs through a credit guarantee scheme, which is being supported by a number of donor institutions. The latter is being negotiated also with commercial banks and expected to be operational in the first part of 2014. The second project, funded by the Ministry of Trade and Industry and the EC, will provide grants for export-oriented SMEs and SMEs producing import substitution goods, with a view to improving technology, increasing production lines and export capacity. The call for proposals will be launched in December, and the first grants are expected to be disbursed in February 2014. We will also launch in January 2014 a project with EU's IPA (Instrument for Pre-Accession Assistance) which will provide technical assistance for export-oriented companies.

19. Several initiatives are in preparation to foster innovation, entrepreneurship and human capital development. First, a law on foreign investment that grants Kosovar investors with double nationality the same protection as foreign investors was passed in first reading, and is expected to be enacted by end-year. We also collaborate with the IFC on streamlining business registration. Second, we are funding innovation centers in Kosovo to promote start-ups and are collaborating with (i) the *South East European Centre for Entrepreneurial Learning (SEECCEL) on integrating entrepreneurship training courses in schools and universities* and (ii) the European Training Foundation (ETF) on developing a national strategy for human capacity building. Our efforts have yielded another improvement of Kosovo's ranking in the World Bank's Doing Business survey to #86 (out of 189), from #126 two years ago. Kosovo ranks this year among the top 5 reformers due to the reforms in opening a business, construction permits, and registration of property. The ranking is now superior to that of several peers in the region.

Sincerely yours,

Hashim Thaçi /s

Prime Minister

Besim Beqaj /s

Minister of Finance

Bedri Hamza /s

Governor, Central Bank of the Republic of Kosovo

Table 1. Kosovo: Quantitative Performance Criteria and Indicative Targets, 2012–13

(Millions of euros; flows cumulative from beginning of the year)

	2012						2013				
	End-Apr.		End-Aug.		End-Dec.		End-Apr.		End-Aug.		
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Adj. Prog.	Actual
Performance Criteria 1/											
Floor on the bank balance of the general government 2/	166	180	237	281	205	216	160	232	171	171	261
Floor on the primary fiscal balance of the general government 2/, 3/	-21	4	-19	6	-112	-113	-37	9	-94	-94	-31
Ceiling on primary expenditures of the general government 3/	399	353	911	842	1,490	1435	448	388	1005	1003	890
Ceiling on the net contracting of nonconcessional debt by the general government 3/	150	30	150	49	150	73	150	20	150	150	60
Ceiling on guaranteeing nonconcessional debt by the general government 3/	0	0	0	0	0	0	0	0	0	0	0
Ceiling on the accumulation of external payments arrears of the general government 4/	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets											
Ceiling on the stock of domestic payment arrears of the central government	0	2	0	0	0	3	0	1	0	0	1
Ceiling on the stock of domestic payment arrears of the general government	0	2	0	3	0	5	0	5	0	0	6
Memorandum items:											
Program assumptions											
Repayment of policy loans extended to public corporations	...	4	4	4	4	4	2	2	4	4	4
Non-project grants	4	1	37	37	37	37	0	0	0	0	0
Budget support loans	0	0	0	0	0	0	0	0	0	0	0
Project grants	1	0	3	0	0	0	0	0	2	0	0
Project loans	0	0	6	0	7	7	2	2	3	3	3
PAK-related spending	...	...	5	4	8	6	2	1	5	5	4

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ Adjusted according to the Technical Memorandum of Understanding.

2/ The end-August and end-December, 2012, and end-April, 2013 PCs have been adjusted to reflect higher than expected budget grants relative to program assumptions, as specified in the TMU.

3/ Excluding PAK related spending from August 2012.

4/ Continuous ceiling on the gross flow of new accumulation.

Table 2. Kosovo: Program Monitoring

Review # Test date	Program Approval	First Review End-April 2012	Second Review End-August 2012	Third Review End-December 2012	Fourth Review End-April 2013	Fifth Review End-August 2013
Performance criteria						
Floor on the bank balance of the general government	...	Met	Met	Met	Met	Met
Floor on the primary fiscal balance of the general government	...	Met	Met	Missed	Met	Met
Ceiling on primary expenditures of the general government	...	Met	Met	Met	Met	Met
Ceiling on the net contracting of nonconcessional debt by the general government	...	Met	Met	Met	Met	Met
Indicative targets						
Ceiling on the stock of domestic payment arrears of the central government	...	Missed	Missed	Missed	Missed	Missed
Ceiling on the stock of domestic payment arrears of the general government	...	Missed	Missed	Missed	Missed	Missed
Prior actions						
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	Met	...	...	...	...	...
Passage of the revised Banking and Microfinance Law in a version consistent with the recommendations of IMF technical assistance	Met	...	...	...	...	...
Issuance of a government decision that specifies spending cuts of €20 million across expenditure categories relative to the approved 2012 budget	Met	...	...	...	...	...
Passage of the 2013 Budget Law by the Assembly, consistent with the objectives of the program.	Met	...	...	...
Issuance of a government decision that specify spending cuts of €11 million across spending categories relative the the approved 2013 budget	Met	...
Submission of the 2013 Mid-Year Budget Review to the Assembly consistent with 19 of the Letter of Intent	Missed 2/	...
Issuance of a government decision that specifies non-allocation of €88 million across expenditure categories	Met
Structural benchmarks						
Publication of budget circulars for municipalities that contain no limits on spending allocations across non-wage categories (by end-May, 2012)	...	Met	...	...	...	...
Submission of a revised Deposit Insurance Fund Law to the Assembly that is consistent with the new Banking and Microfinance Law (by end-May, 2012)	...	Met with delay	...	...	...	...
Amendment of the Law on Public Financial Management and Accountability by a provision that specifies that only the central bank can dispose over the funds in the Special Reserves Fund designated for Emergency Liquidity Assistance (by June 15, 2012)	...	Met	...	...	...	...
Launch of the tender offer for PTK (by end-August, 2012)	Met with delay	...	...	...
Submission of the 2013 Budget, consistent with the objectives of the program, to the Assembly (by end-October).	Met	...	...	...
Submission of an economic viability study for highway R6 to the World Bank and IMF staff (by end-January, 2013)	Missed 3/	...	...
Submission of legislation to the assembly on the Rules-Based Fiscal Framework that is consistent with ¶11 of the Letter of Intent as of Dec 5th, 2012 (by end-March 2013).	Met	...	...
Approval of the amended financial rules 02 and 04 of the Treasury to ensure the recording of all payment-related documents within 3 days in the IT system (by End-May 2013). 3/	Met 4/	...
Approval by CBK's Executive Board of an instruction to pay for legal representation of staff when they are sued for carrying out official duties in good faith (by End-May 2013).	Met	...
Drafting of secondary legislation to provide for a more rules-based treatment of setting minimum wage levels (by end-May 2013)	Met	...
Issuance of an administrative instruction to provide for a rules-based setting of minimum wage levels consistent with ¶121 of the Letter of Intent as of Jun 28th, 2013 (by end-August 2013).	Met
Submission of a 2014 budget to the Assembly consistent with ¶112 of the Letter of Intent as of Jun 28th, 2013 (by end-October 2013).	Missed 5/
Continuous structural benchmarks						
Monthly meetings of the Program Monitoring Committee and transmission of meetings' minutes to the IMF	...	Met	Met	Met	Met	Met
Inclusion of a paragraph into all new benefit creating laws, amendment to laws or regulations that allows cutting benefits if budgetary funds are unavailable 1/	...	Missed	...	...	...	...
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	...	Met	Met	Met	Missed 2/	Met
1/ Eliminated after the first review following a corresponding amendment of the Law on Public Financial Management and Accountability.						
2/ The 2013 Mid-Year Budget Review contained a spending allocation for an unspecified benefit to erstwhile political prisoners without prior compilation of a fiscal impact assessment.						
3/ The study was submitted on time, but did not contain all the elements defined in the LOI of December 2012.						
4/ The amended financial rules have been renumbered rules 01 and 02.						
5/ The ceiling on current spending was exceeded by €12 million, although for reasons outside the central government's control (the cost of implementing Law No. 04/L199 - that relates to the strengthening of municipalities in Northern Kosovo - and a higher share of current spending by municipalities).						

Attachment: Technical Memorandum of Understanding

Definitions and Data Reporting Requirements under the 2012–13 Stand-By Arrangement

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 onlending 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 were € 159.986 million at December 31, 2011, and € 215.587 million at December 31, 2012.

- The floor on the bank balance set in Table 2 will be raised by
 - the excess of budget grants and loans relative to program assumptions
 - the excess of privatization proceeds, including from the telecommunication company (PTK) and the receipt of transfers from the Privatization Agency of Kosovo (PAK) relative to program assumptions

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. Expenditures of the Privatization Agency of Kosovo (PAK) are excluded. 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 2 will be raised by the excess of project grants and loans relative to program assumptions.
- The ceiling on primary expenditures set in Table 2 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 Root 6, 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. Expenditures of the Privatization Agency of Kosovo (PAK) are excluded. Revenues do not include privatization receipts.

- The floor on the primary fiscal balance set in Table 2 will be lowered by the excess in project loans relative to program assumptions.
- The floor on the primary fiscal balance set in Table 2 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 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. 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.

23. 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.