International Monetary Fund

Republic of Kosovo
and the IMF

Country's Policy
Intentions Documents

Republic of Kosovo: Letter of Intent and Technical Memorandum of Understanding

December 15, 2011

The following item is a Letter of Intent and a Technical Memorandum of Understanding of the government of the Republic of Kosovo. It is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that the Republic of Kosovo is implementing in the framework of a staff-monitored program. A members' staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

REPUBLIC OF KOSOVO

LETTER OF INTENT

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

Pristina, December 15, 2011

Dear Ms. Lagarde:

1. Economic activity in Kosovo has remained robust, supported by buoyant domestic demand and solid credit growth, while our financial system remains well capitalized and liquid. However, downside risks have increased owing in part to the deteriorating outlook for the euro area. A protracted weakness in activity in Europe could negatively affect remittances and foreign direct investment from Kosovars living abroad, and therefore constrain an important source of funding for the Kosovar economy. Our policy strategy is based on steadfast commitment to disciplined fiscal management—including through safeguarding sufficient government cash buffers—the further strengthening of surveillance and the regulatory framework of Kosovo's financial system, and progress with structural reforms to boost competitiveness. These policies provide the best safeguard to steer the Kosovar economy successfully through the period ahead and enhance its medium-term growth prospects.

2. Implementation of our Staff-Monitored Program (SMP) that was initiated in June has been largely successful to date.

- *Quantitative benchmarks* for end-September were all met with the exception of the benchmark on accumulation of domestic arrears, where a minor amount has been accumulated. Reforms are underway to improve our ability to monitor overdue bills and reduce the likelihood of arrears built-up (¶16).
- The *structural benchmark* on publication of our tax compliance strategy was also met, as were the continuous structural benchmarks on monthly meetings of our program monitoring committee and on inclusion of a clause into all laws that create new or modify existing benefits to permit adjustment of the benefits to the amounts available in the budget.

3. Moreover, we have submitted a budget for 2012 to the Assembly that is consistent with our commitment to achieve ¾ of a percent of GDP in structural fiscal adjustment, as

part of our strategy stretching over a period of 4 years to restore a sustainable fiscal stance (¶10). Passage of this budget is a structural benchmark under the SMP for end-December.

4. Looking ahead, meeting some other end-December program targets has become infeasible, and we request corresponding modifications of benchmarks.

- The privatization of the post and telecommunications company PTK will not go forward this year, as one of the two pre-qualified bidders has dropped out of the process, forcing us to cancel the auction and restart the process. We had expected to raise at least €300 million with the privatization. This delay will cause us to miss the end-December structural benchmark on PTK privatization. To limit the impact of the delayed privatization on our bank balances with the central bank (CBK), we have enacted spending cuts of €60 million, as agreed under the SMP. We request to introduce adjusters to the quantitative benchmark on bank balances for both the shortfall in privatization receipts and the impact of the corresponding spending cuts, and to the quantitative benchmarks on primary expenditures and the primary fiscal balance for the spending cuts in reaction to the delay in PTK privatization.
- We also request to modify the end-December structural benchmark on fiscal impact assessments for the planned war veteran pension and possible benefits for former political prisoners. Delays in getting the work started and a methodology suggested by the World Bank that is more time consuming than originally anticipated render the end-December deadline for completion of these assessments infeasible. We request to modify the benchmark to setting up working groups to prepare the methodology for the impact assessments and defining the groups' terms of reference in cooperation with the World Bank.

5. We believe that the policies set forth in our letter of June 20, 2011 and this letter is adequate to achieve the objectives of our economic program. However, the Government stands ready to take additional measures as appropriate to ensure achievement of its objectives. We will consult with IMF staff before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the program, and provide IMF staff with the necessary information for program monitoring. We authorize IMF staff to publish this letter.

I. Macroeconomic Outlook

6. We have marked down our projection for real GDP growth in 2011 by 0.3 percentage points to 5 percent, reflecting the spending cuts in reaction to the delay in PTK privatization. For 2012, we are basing our policy framework on a cautious real growth forecast, reflecting among other things the worse growth outlook for the euro area and the possible knock-on effects on domestic demand through lower remittances and capital inflows. The current account deficit is expected to improve to about 21 percent of GDP in 2012, from 24 percent in 2011, reflecting mostly weaker imports.

7. Consumer price inflation is projected to continue to fall rapidly throughout end-year, reflecting rapidly declining food prices. In 2012 we expect this process to continue, with inflation falling to around 2 percent, even though possible increases in electricity prices as a result of new regulations on electricity tariffs and coal royalties may yield some counteracting price pressures.

II. Fiscal Policy for 2011 and 2012

8. We intend to continue to strictly adhere to the budgetary ceilings for 2011, while taking measures as needed to safeguard an adequate minimum level of cash buffers through end-year.

- *Revenues.* Tax revenue collection through September was €24 million higher than targeted under the SMP, owing to a stronger than expected performance of indirect taxes (VAT and excises). On current trends, we expect to exceed our end-year revenue targets somewhat, reflecting inter alia factors such as one-off payments by PTK for licensing fees and a budgetary grant from the World Bank that was originally expected for 2012.
- *Expenditures.* The end-year targets for primary expenditures are well within reach, based on continued disciplined budget execution. In response to the delay in PTK privatization, we have enacted contingent spending cuts on goods and services, subsidies and transfers, and net lending for the electricity sector, and non-highway spending, to prevent that our bank balances with the central bank fall too far below recommended levels.

9. Our draft 2012 budget submitted to the Assembly at end-October targets a primary deficit of €159 million (3.2 percent of GDP). The budget is built on (i) cautious revenue projections, seeking to preserve the gains in tax collection made in 2011 while building in some buffer in view of the uncertain growth outlook; (ii) restraint on current and non-highway capital spending; and (iii) the acceleration of spending on highway R7, to set the ground for a successful completion of R7 in 2013 (¶11).

10. The 2012 will budget contain €38 million (¾ of a percent of GDP) in structural adjustment that is composed of the following measures:

- *Restraint on public sector wages, €10 million* (0.2 percent of GDP). The budget contains zero wage increases for public sector employees. The wage bill is nonetheless expected to increase somewhat because of (i) the full-year effect of the 2011 wage hikes (that took effect in March 2011), and (ii) the hiring of new public sector employees, reflecting inter alia the creation of new municipalities in Kosovo's North and the transfer of responsibilities (special police, privatization fund) from the international community to the Kosovar government.

- *Electricity sector, €15 million (0.3 percent of GDP).* Reforms in the electricity sector—notably better revenue collection by the electricity company KEK (that materialized already in 2011) and regulatory measures—allow cutting subsidies by €10 million and gross lending to the sector by €5 million.[1] Of the remaining subsidies of €20 million, a maximum of €13 million will be budgeted for KEK, while the remainder will be placed in a budgetary reserve. The lower amount of KEK-subsidies should affect electricity prices, in line with the regulatory formula.
- *Revenue measures, €13 million (0.25 percent of GDP).* These include increases in the excise on tobacco by €2 per 1000 units (yielding about €7 million), the minimum property tax rate to 0.15 percent (€3 million), and the presumptive tax to 9 percent (€3 million); broadly in line with recommendations of a recent IMF TA mission on tax policy (¶15).

11. The expansion and modernization of our highway network remains a strategic priority. Our highway projects need to be managed carefully, however, to assure sustainability of the public finances.

- *Highway R7 to Albania.* The 2012 budget increases the amount for R7-related expropriations to €56 million, with the objective of finalizing expropriations in 2012 to the extent possible, to set the stage for the timely completion of R7 in 2013 that is needed to avoid cost escalation clauses that would materialize from 2014. Budgetary risks emanating from R7 need to be managed especially carefully as the project nears completion. We will make every effort to keep costs as small as possible, including variation costs reflecting changes from and additions to the original contract.
- *Highway R6 to Macedonia.* The 2012 budget contains no allocation for the planned R6 highway in view of tight financing constraints, the need to revisit technical specifications, and insufficient information about the final costs from highway R7 that complicate medium term budgetary planning. We will use 2012 to advance technical and financial preparations for R6. With the currently planned design, only the northern section of R6 close to Pristina is economically viable. We will therefore revise, in collaboration with the World Bank, technical specifications and analyze different design and financing options for the southern portion of R6.

12. To finance the 2012 deficit, the government will issue sovereign paper for the first time in Kosovo's history. To this end, the central bank has successfully tested a new platform for electronic bond trading. A debt strategy paper, developed with the technical support from

[1] Structural measures are assessed relative to the passive (=no measures) scenario inscribed, inter alia, into the IMF's 2011 Article IV Report.

the U.S. Treasury, is expected to be published by year-end. We anticipate that at least €75 million can be purchased by domestic banks and the Pillar II pension fund KPST. However, for this to be possible we need loosen the strict investment constraints for KPST currently inscribed into the pension fund law that prohibit KPST from being exposed to a single borrower with more than 5 percent of its portfolio. We will replace this constraint with provisions that limit (i) KPST's overall exposure to the government to 30 percent of KPST's assets, and (ii) KPST's annual purchases of government paper to at most 50 percent of new inflows into KPST in the preceding year. We will consult closely with World Bank and IMF staff on the wording of the corresponding articles in the pension fund law. Submission of the revised law to the Assembly is envisaged for end-December (structural benchmark).

13. While we remain committed to finalizing the privatization of PTK in 2012, we are developing a back-up plan in case that further delays may occur. The back-up plan aims at ensuring that bank balances are at least €150 million by end-December 2012, even in the absence of PTK privatization. To this end, we will leave €60 million in the 2012 budget unallocated. By February 2012, we will specify the expenditure categories that will be affected by the back-up plan, unless there is clear evidence by then that privatization of PTK in 2012 is ensured. Additional measures may be needed to achieve the envisaged minimum level of bank balances that would likely consist of a mix of revenue and financing measures. Also these measures would be identified no later than February 2012.

14. We have ensured passage of the law regulating the benefits for war-related categories by the Assembly in a form consistent with the government's commitments specified in the paragraphs 13-15 of the LOI from June 20, 2011 (prior action). More generally, to facilitate budgetary planning and execution, we remain committed to the principles that (i) all new laws or amendments to laws that create benefits will grant only cash benefits, with no link to the minimum wage; (ii) all such laws will be preceded by a thorough fiscal impact assessment over a period of at least 5 years; (iii) and such laws include a paragraph that explicitly allows cutting benefits in case of insufficient budgetary funds.

III. STRUCTURAL FISCAL REFORMS

15. We remain committed to achieving a sustainable fiscal stance through structural adjustment of 3 percent of GDP over a period of 4 years, half of which remains to be implemented in 2013/14. Going forward, it is likely that a significant part of the structural adjustment effort will come from revenue policies. Further, over the longer term a strategic re-orientation of the tax system is called for to reduce our dependence on border taxes. The recent recommendations by an IMF technical assistance mission on tax policy provide a useful yardstick for these endeavors, oriented on best international practices. Meanwhile, we will protect the integrity of our current tax system and will, in this context, refrain from introducing tax holidays and/or exemptions for intermediary inputs from VAT. To enhance our capacity to devise and analyze tax policies, we will merge the macroeconomics and fiscal policy divisions within the Ministry of Finance by end-December.

16. We are upgrading our public financial management software, with a view to enhancing our capacity to monitor overdue bills and prevent the accumulation of domestic arrears. The software will be tested at end-2011. The new monitoring system will be fully operational once the budget officers in all budget organizations have been trained in the use of the software. We expect this to be the case in the second half of 2012.

17. We are conducting an analysis of the inter-governmental grants system, in cooperation with a technical assistance mission from the IMF, with a view to enhancing the effectiveness of the system. Should this analysis result in a reduction of budgetary grants, we would compensate for this by increasing own source revenues of municipalities, for example by further raising minimum property tax rates or municipal fees on motor vehicles. We also intend to grant municipalities more flexibility in allocating resources in line with spending needs.

18. A preliminary version of the 2012 tax compliance strategy was completed in September and is published on the Tax Administration website. This version has been reviewed by stakeholders and is currently being upgraded, in cooperation with technical assistance from the IMF.

IV. Monetary and Financial Sector Policies

19. The financial system has remained well-capitalized, liquid, and profitable. Capital adequacy stood at 17.2 percent at end-October, while non-performing loans have continued to hover around 6 percent. Credit to private sector grew by about 15½ percent in the 12 months to October. A new management of Kosovo’s largest microfinance institution has been appointed in November. The central bank plans to keep the current administrator until end-December 2011 to allow a smooth transition. Since the Central Bank’s intervention in the institution in 2011 due to governance concerns, it has strengthened its liquidity position and recovered profitability.

20. Against the backdrop of the international financial crisis, we have upgraded prudential policies with a view to safeguard sufficient liquidity and capital buffers in case of external strains. Measures include:

- the central bank is acquiring the ability to provide emergency liquidity assistance (¶21);
- a deposit insurance scheme has been introduced;
- the legal framework for bank resolution and prudential regulation has been strengthened with the new central bank law and will be strengthened further with the upcoming banking and microfinance law (¶21);
- the central bank is committed to maintaining prudent loan-to-deposit ratios of around 80 percent;

- the central bank issued regulations limiting banks' exposure to their foreign controlling institutions to 20 percent of Tier 1 capital, containing the risk that liquidity strains on the controlling institutions could spread to their Kosovar affiliates;
- we will reduce banks' exposure limits to single borrowers from 20 percent of Tier 1 capital to 15 percent with the new banking and microfinance law;
- to contain liquidity risk, we will maintain prudent rules on the assets that are eligible to fulfill banks' minimum reserve requirements. In particular, Kosovar government paper will remain non-eligible, as long as the market for such securities remains thin and the investor base insufficiently diversified. However, banks will be allowed to apply a zero risk weight to government paper for capital adequacy purposes.

We are confident that these measures provide strong support for our financial system to withstand strains, but are prepared to take additional measures as needed, such as requesting banks to temporarily suspend dividends payments to increase capital buffers.

21. Good progress is being made with financial sector structural reforms.

- *Emergency Liquidity Assistance (ELA).* The Ministry of Finance (MoF), the CBK, and the Committee for Budget and Finance have signed a Memorandum of Understanding that establishes duties and responsibilities with respect to ELA. The Board of the CBK approved regulations governing ELA in November. Further, we will modify the government's budget law for 2012 to contain a provision to deposit €46 million in a CBK account earmarked for ELA. The CBK will provide another €46 million for ELA with its own resources.
- *Banking and Microfinance Law (BML).* The draft law on banking and microfinance institutions has been finalized, in close cooperation with the IMF and the World Bank, and been submitted to the Assembly. The law will enhance governance in financial institutions and tighten prudential regulations regarding portfolio concentration and lending to related parties.
- *Deposit Insurance Law (DIL).* We plan to revise the DIL, including authorizing the CBK to use the Deposit Insurance Fund for purchase and assumption transaction, to ensure consistency with the BML. We expect to submit the revised DIL to the Assembly in the first half of 2012, after the BML is adopted. The CBK has collected about €5 million from banks and the government for the deposit insurance fund, and expects to receive €4.5 million from KFW and another US$4 million from the government, facilitated by a World Bank loan.

V. Other Issues

22. Ongoing reforms in the energy sector aim at enhancing the quality of electricity supply and reducing the dependence of the sector on the government budget. The regulator will issue key financial variables of the revised energy pricing formula before end-year, to

enable pre-qualified companies to make bids for the privatization of electricity distribution. The privatization schedule is somewhat behind earlier plans, reflecting the change of the transaction advisor. On current plans, the winning bid for the privatization of distribution will be announced in early 2012, with the subsequent transfer in ownership shares. Preparations for the privatization of mining and electricity generation are ongoing, with the Request for Proposals to be issued in the first quarter of 2012. A report on staffing and a functional audit of the coal division of KEK will be completed by end-2011.

23. We are in the process of preparing an overhaul of our healthcare system. A key element of the draft reform is a health insurance fund financed by premium payments from the insured. No budgetary allocation for the reform is made in the context of the 2012 budget. Moreover, total transfers from the treasury to the insurance fund, including premia paid on behalf of the poorest Kosovar citizens, will be designed to not exceed existing budget allocations for healthcare, thus the reform will have no direct budgetary impact also in the medium term.

24. We have prepared a package of twelve laws that aim at strengthening the business environment and improving our ranking in the Doing Business survey of the World Bank. Some laws—on enhancing business management, property rights, internal trade, information reporting and auditing—have already been passed. To safeguard labor market competitiveness and the employability of women, an annual report on the implementation of the labor law will be conducted in early 2012, with the emphasis on the maternity leave provisions and in close cooperation with the World Bank.

/s/

Hashim Thaçi

Prime Minister

/s/	/s/
Bedri Hamza	Gani Gërguri
Minister of Finance	Governor, Central Bank of the Republic of Kosovo

Table 1. Kosovo: Program Monitoring, September 2011

Quantitative benchmarks	
Floor on the bank balance of the general government	Met
Floor on the primary fiscal balance of the general government	Met
Ceiling on primary expenditures of the general government	Met
Ceiling on contracting or guaranteeing nonconcessional debt by the general government	Met
Ceiling on the accumulation of domestic payment arrears of the central government	Missed
Ceiling on the accumulation of external payments arrears of the general government	Met
Prior actions for the initiation of the SMP (June 2011)	
Dissolve the committee reviewing eligibility for all current categories of war related benefits and freeze the number of beneficiaries at a maximum corresponding to the level at end-May 2011, with the exception of applications that have already been received by that date	Met
Issue a sub-legal act on the “Law on the Rights of Formerly Politically Convicted and Persecuted Persons” that determines that the benefits payable under this law shall only be paid from funds that have been specifically and explicitly appropriated for this purpose under the then applicable budget law	Met
Structural benchmarks	
Development of a taxpayer compliance strategy aligned with the TA recommendation	Met
Continuous structural benchmarks	
Monthly meetings of the Program Monitoring Committee and transmission of meetings' minutes to the IMF	Met
Inclusion of a paragraph into all new benefit-creating laws and amendments to laws allowing to cut benefits if budgetary funds are unavailable	Met

Table 2. Kosovo: Quantitative Benchmarks (QB) and Indicative Targets (IT), 2011

(Millions of euros, cumulative from beginning of the year)

	2011						
Test date	Jun.		Sep.		Dec.		
Type of objective	IT	Act.	QB adjusted 1/	Prelim.	QB	QB adjusted 1/ 2/	Proj.
Objective to be observed							
Floor on the bank balance of the general government	249	255	200	246	305	90	107
Floor on the primary fiscal balance of the general government	27	54	-20	43	-226	-144	-127
Ceiling on primary expenditures of the general government	537	528	913	893	1,487	1,433	1,426
Ceiling on contracting or guaranteeing nonconcessional debt by the general government	0	0	0	0	0	0	0
Ceiling on the accumulation of domestic payment arrears of the central government 3/	…	1	0	0.3	0	0	0
Ceiling on the accumulation of external payments arrears of the general government 4/	0	0	0	0	0	0	0
Memorandum items:							
Ceiling on the accumulation of domestic payment arrears of the general government	…	4	0	2	0	0	0
Program assumptions							
New privatization receipts from PTK	0	0	0	0	300	0	0
Spending cuts contingent on non-privatization of PTK	0	0	0	0	0	60	60
Non-project grants	5	3	5	3	5	23	23
Budget support loans	0	0	0	0	0	6	6
Project grants	0	1	0	1	2	6	6
Project loans	0	0	0	0	2	4	4

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

1/ The floors and ceilings are adjusted according to the applicable Technical Memorandum of Understanding.

2/ Adjusted in line with expected application of adjustors by end-December.

3/ A zero ceiling on the stock of domestic arrears of the central government is to be observed at end-June 2011; a zero ceiling on the accumulation of new domestic payment arrears by the central government is to be observed continuously beginning in July 1, 2011.

4/ To be observed continuously.

Table 3. Kosovo: Prior Action and Structural Benchmarks

Actions	Type	Timing
Passage of the law regulating benefits for war-related categories by the Assembly in a form that is consistent with the Letter of Intent of June 20, 2011, or withdrawal of the law from the Assembly	Prior Action	December 10, 2011
Passage of a budget for 2012 by the Assembly agreed with IMF staff that contains fiscal tightening of at least ¾ of a percent of GDP, based on realistic macro-forecast and prudent budgeting	Structural benchmark	End-December 2011
Completion of the privatization of PTK	Structural benchmark	End-December 2011
Submission to the Assembly of a revised law on the Kosovo pension fund that limits both (i) exposure of the Pillar II pension fund (KPST) to the general government to 30 percent of its total portfolio and (ii) annual purchases of government paper by KPST to 50 percent of the new inflows into KPST in the previous calendar year	Structural benchmark	End-December 2011
Setting up working groups to prepare the methodology for fiscal impact assessments for (i) the planned war veteran pension and (ii) possible benefits for former political prisoners, and defining the groups' terms of reference.	Structural benchmark	End-December 2011
Inclusion of a paragraph into all new benefit-creating laws and amendments to benefit-creating laws that explicitly allows cutting the level of benefits in case sufficient budgetary funds are unavailable	Structural benchmark	Continuous
Monthly meetings of the Program Monitoring Committee as defined in paragraph 38 of the Letter of Intent to assess progress with implementation of the SMP and consistency of all relevant policy initiatives with the SMP's objectives, and transmission of the meetings' minutes to the IMF Resident Representative within 5 business days	Structural benchmark	Continuous

REPUBLIC OF KOSOVO

TECHNICAL MEMORANDUM OF UNDERSTANDING

Definitions and Data Reporting Requirements under the 2011 Staff-Monitored Program

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Kosovo authorities and the IMF staff regarding the definition of quantitative benchmarks and indicative targets, and reporting requirements for the Staff-Monitored Program ("SMP") requested in June 2011.

I. QUANTITATIVE BENCHMARKS AND INDICATIVE TARGETS

A. Coverage

2. For the purpose of this memorandum, **general government** is composed of the Executive, the Legislative, and Judiciary branches of the Government, its Municipalities, and any other public authorities that receive direct budgetary appropriations. It excludes publicly owned enterprises and socially owned enterprises.

3. **Quantitative Benchmarks and Indicative Targets.** The quantitative benchmarks, indicative targets, and their respective test dates are set in Table 2 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 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 foreign banks, domestic banks, and 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, 2010, were € 244.112 million.

- 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 repayment of loans extended to public enterprises.
- spending cuts of €60 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end-2011.

➢ The floor on bank balance set in Table 2 will be lowered by €300 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end 2011.

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 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.
- spending cuts of €60 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end-2011

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 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.
  - spending cuts of €60 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end-2011

E. Contracting or 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). The ceilings exclude purchases from the IMF, the sale of the SDR holdings allocated to Kosovo, and the contracting of Partial Risk Guarantees with the World Bank for the privatization of the energy sector. Debt rescheduling and debt reorganization of debts contracted before the approval of the SMP are excluded from the limits on nonconcessional debt. The definition of short-term nonconcessional debt excludes normal short-term (less than one year) import-related financing. The quantitative benchmark applies 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.

11. 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 benchmark.

12. **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."

13. **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

14. 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. The stock of arrears will be assessed at end-June 2011 and the accumulation of new domestic arrears will be assessed continuously. A payment obligation is defined to be domestic if the creditor is resident in Kosovo.

15. **Reporting requirements.** The Ministry of Finance will submit detailed tables of the stocks of domestic arrears and of domestic payment obligation to suppliers or creditors not in arrears as of end-September and end-December 2011. Moreover, it will submit a monthly table with the stock of domestic payments arrears, including the accumulation (if any), payment, rescheduling and write-off of domestic payments arrears during the month. The data are to be provided within five weeks after the end of the month.

G. External Payments Arrears

16. **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.

17. **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

18. 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

19. 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.

20. A preliminary quarterly balance of payments, compiled by the CBK, will be forwarded within three months after the end of each quarter.

21. 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.

22. 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.