



Kosovo: Presentations of the Analytical Work

2021 ARTICLE IV CONSULTATIONS

OCTOBER 29, 2021

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Oana Luca



Kosovo: Macroeconomic Implications of a Large Diaspora

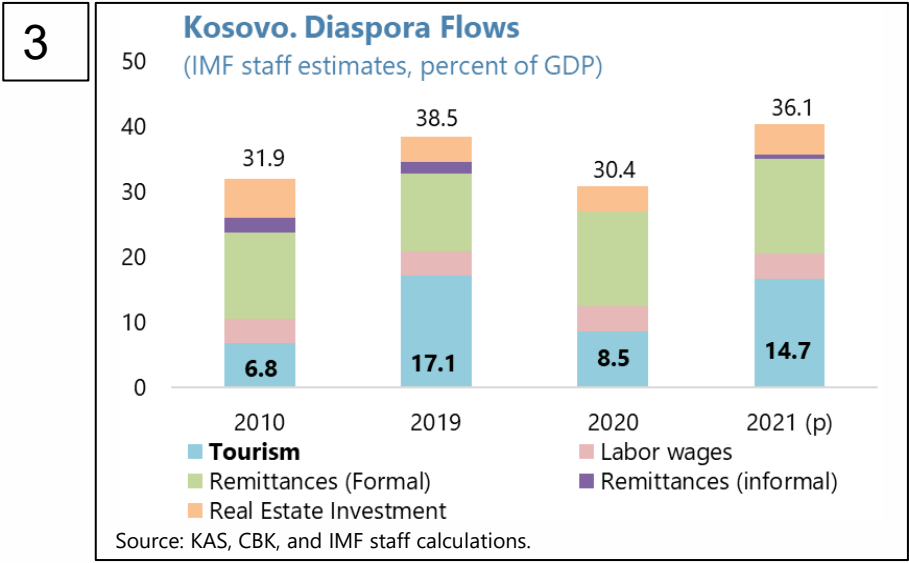
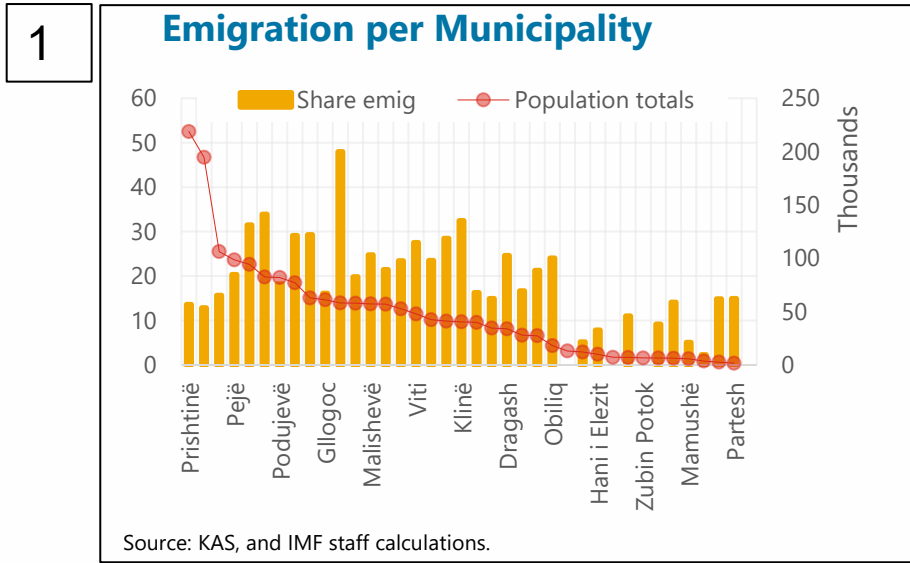
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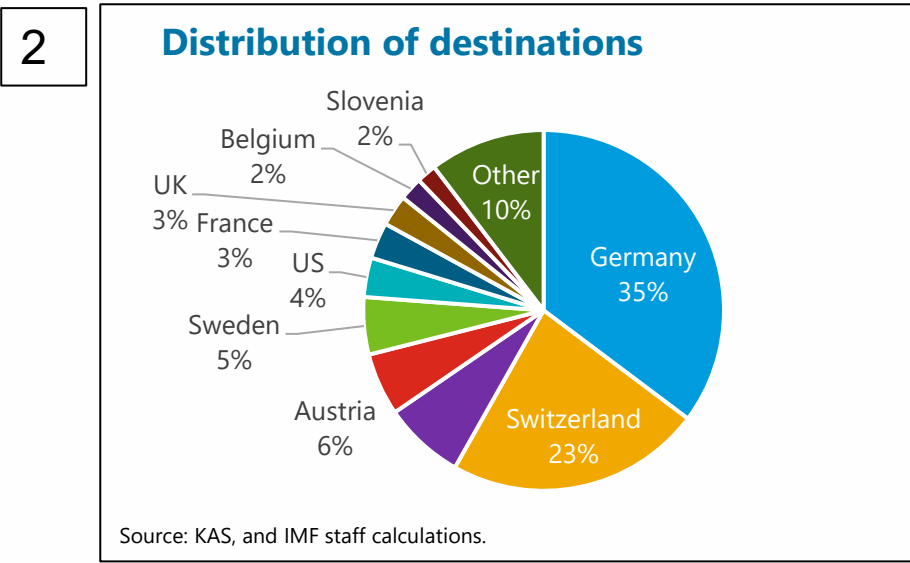
Francisco Roldán
IMF European Department

Diaspora Flows dominate Kosovo's Economic Developments

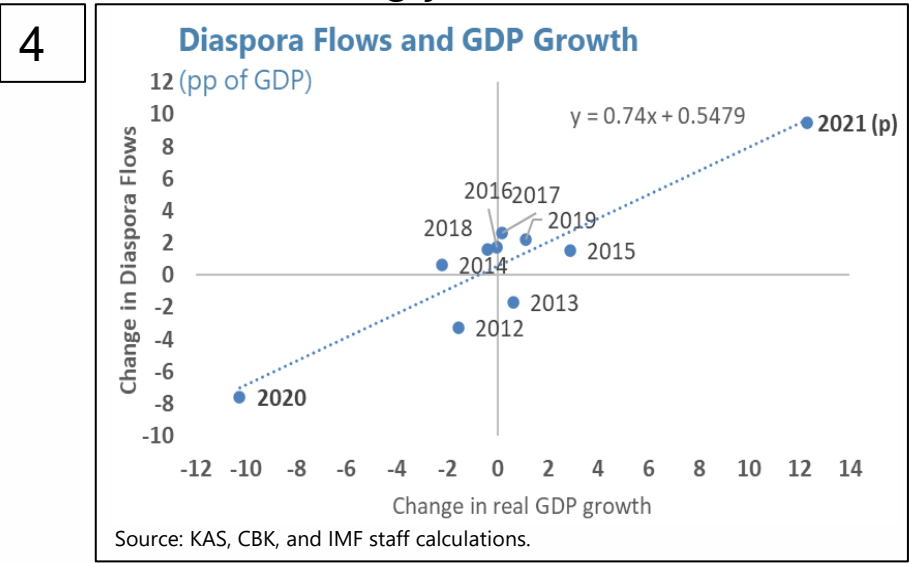
Emigration is above 20% in medium-sized cities... This leads to large Diaspora-related flows...



...with a vast majority residing in advanced economies



...which strongly comove with GDP



Diaspora Flows and Resource Allocation: A Non-Traded Bias

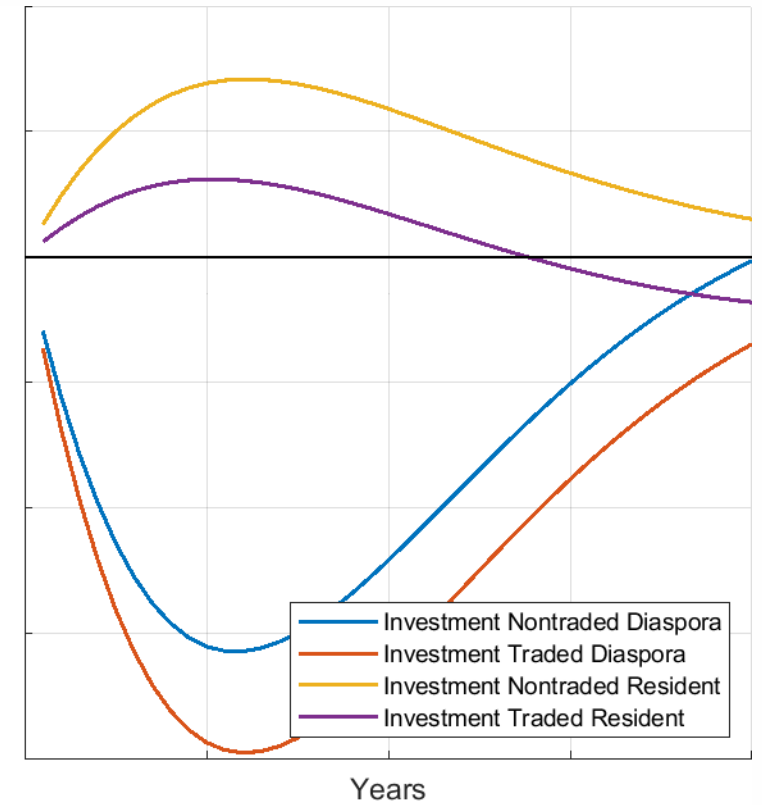
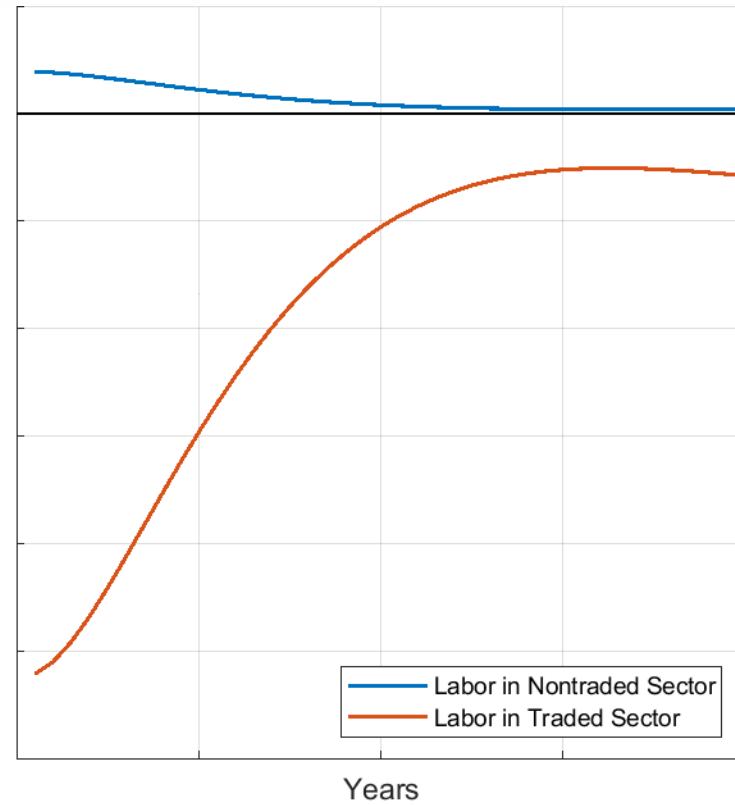
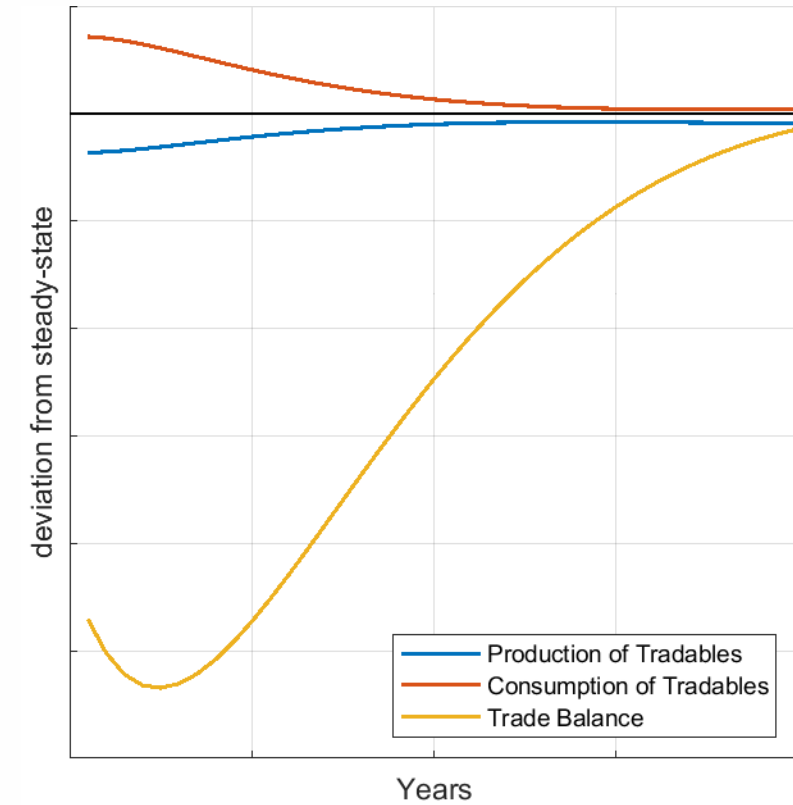
- We build a general equilibrium model of diaspora flows
 - Traded and nontraded goods
 - Sector-specific capital adjustment costs
 - Capital owned by both residents and the diaspora
 - Diaspora send **remittances** and demand **nontraded** goods when visiting
- Diaspora blurs the line between traded and nontraded goods
 - **Diaspora visits = nontraded goods can be exported**
- Increases in demand lead to investment in nontraded sector
 - Diaspora creates a ***nontraded bias*** in the economy

Labor & Capital Flow to Non-Traded Goods when Diaspora Flows Increase...

Demand for tradables creates a trade deficit...

...a reallocation of labor towards the nontraded sector...

...and a concentration of investment on the nontraded sector and residents



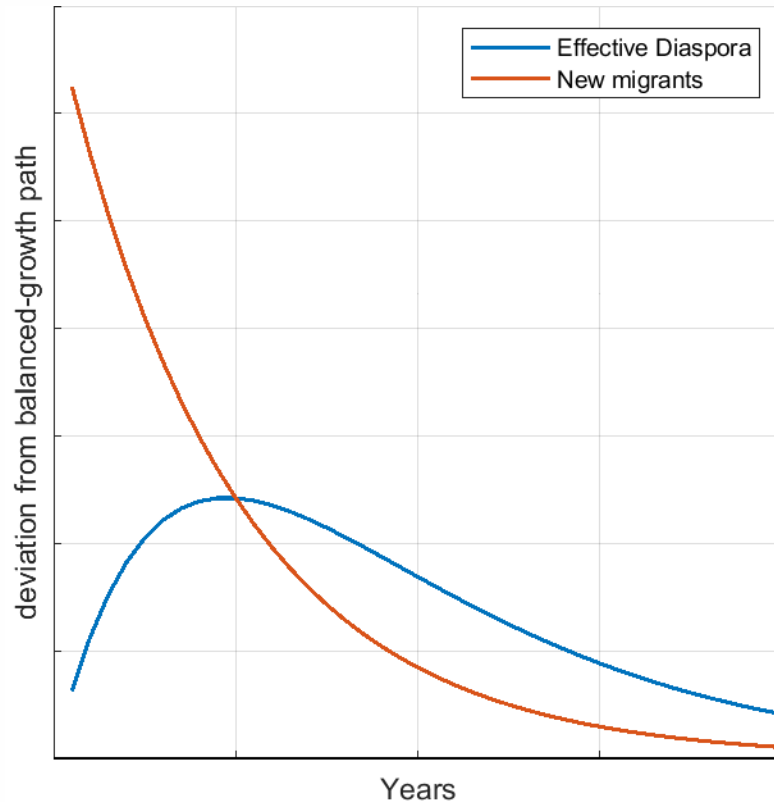
Source: IMF staff calculations.

Diaspora Flows and Economic Growth: Is it Sustainable?

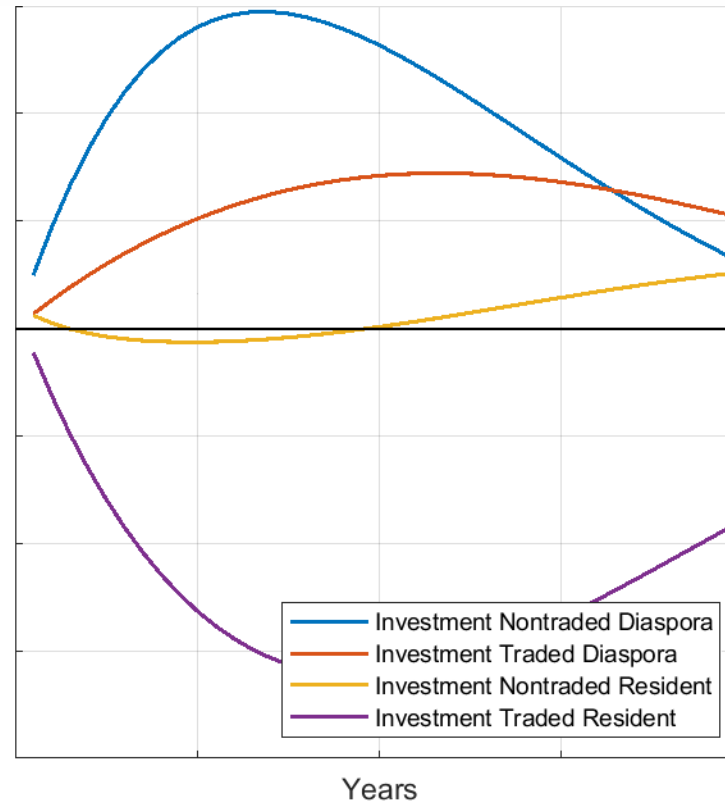
- What factors drive the **growth** of diaspora flows?
 - **Size** of diaspora and the strength of its **ties** with the motherland – **effective diaspora**
 - Higher per capita income in the host economy with respect to Kosovo
 - The growth rate of the host economy + life-cycle effects
- **Our model results in three phases for diaspora flows:**
 1. **Expansion**: growth of effective diaspora dominates
 2. **Stabilization**: erosion of ties dominates, effective diaspora shrinks, growth slows
 3. **Long-run**: same growth as host country

Diaspora-led Growth: A Strong Short-Term Push That Fades in the Long-Term

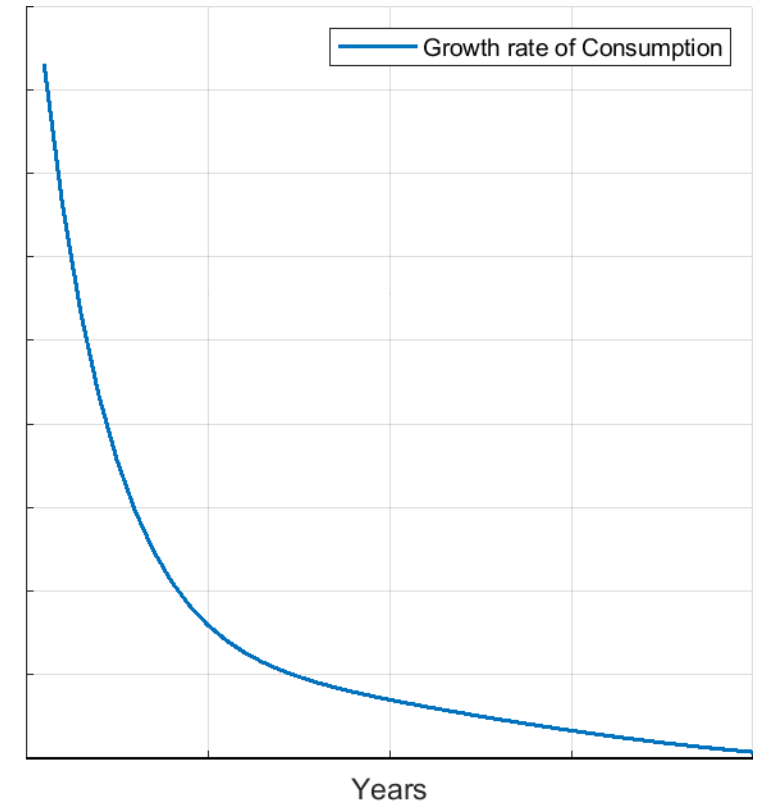
While migration increases the size of the diaspora, their ties with the motherland fade over time...



...diaspora flows push growth up, but nontraded bias remains...



Growth is fast initially but slows down as the size of the diaspora stabilizes



Source: IMF staff calculations.

Conclusion: Need for New Growth Engines

- **Diaspora provides strong growth engine in short run**
 - Remittances are a form of implicit insurance
 - Diaspora provide **demand for nontraded goods** without the need to develop external markets
- However, **investment incentives reinforce diaspora-dependence and limit long-run growth**
 - Use diaspora-led growth to close physical and social infrastructure **gaps**
 - Create effective ties with diaspora **entrepreneurs**
 - Diversify export markets and go up the value chain by **investing the diaspora boon**
 - Advance decisively in EU – SAA implementation





Kosovo: Expanding the Market for Government Securities

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Si Guo

IMF European Department



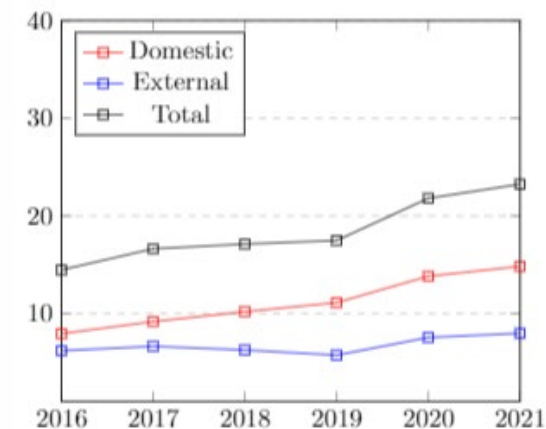
Context

- Rising government debt
- 1st diaspora bond issued (Aug-2021) -- to expand investor base

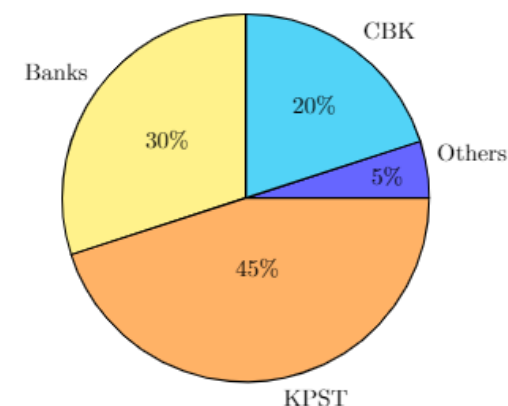
This Presentation

- Domestic government debt demand: close to its limit
- Options to expand debt demand
- Prospective of issuing external bonds

Kosovo Government Debt (% of GDP)



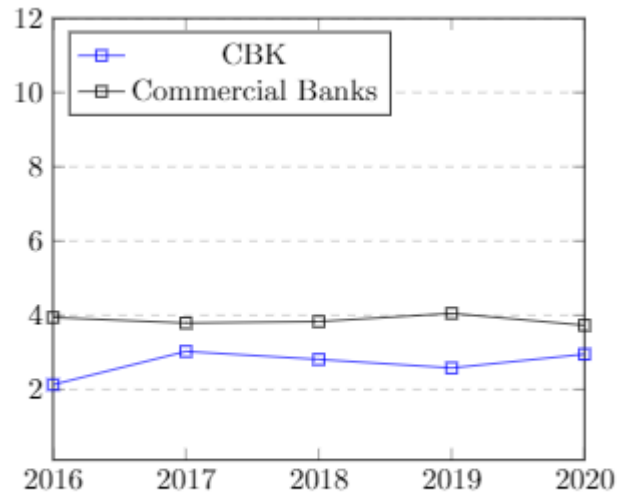
Domestic Debt Creditors



Data source: MFLT; KAS; CBK;
Staff calculations and projections.

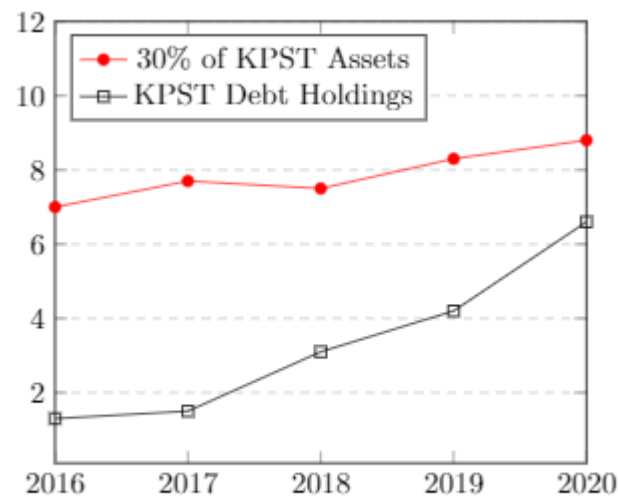
The Demand Upside for Government Securities in Domestic Markets is Limited...

CBK and Banks: stable holdings, additional demand less likely



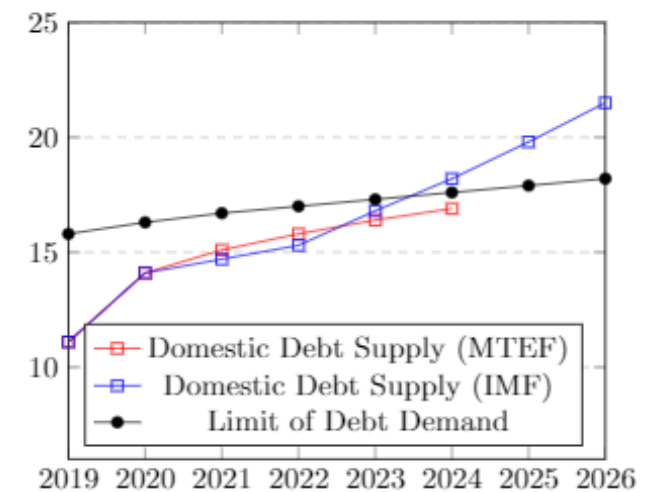
CBK and Banks' Holdings (% of GDP)

KPST: Capped at 30% of its assets, has some room for additional demand.



KPST's Holdings and Limits (% of GDP)

Summing up: debt supply may exceed demand soon, depending on deficits and KPST asset growth



Proj. Debt Demand Limit and Supply (% GDP)

Data source: MFLT; KAS; CBK; KPST; Staff calculations and projections.

...and while a few options are available in the short-term, the long-term solution is the development of Kosovo's capital market.

➤ Main problem:

- Ample liquidity that cannot be channeled to the government bond market.

➤ Longer-term solutions

- Develop the capital market
- Obtain a good rating (BBB- above) -- require changes to economic fundamentals.

➤ Short to Medium-term solutions

- Diaspora/retail bonds – directly channel household savings to bond investment
- External bonds (next slide)
- Initiate the process to get a country risk rating from an internationally reputable credit rating agency
- Offer short-term securities to test the market demand

Expanding External Demand for Kosovo's Government Securities: Prospective pricing of a Eurobond issuance

- Need a sovereign rating first.
- Most likely between **B to BB-** based on model projections.

	Kosovo (2019)	Economies with B- to BB+	Economies with BBB- to BBB+	Economies with A- and above
Gov. debt (% GDP)	17.6	63	55	55
3-yr Fiscal balance (% GDP)	-2.4	-3.3	-2.3	-0.8
GDP Per capita (in \$)	4,462	6,700	16,209	41,809
Reserves (months of imports)	2.3	5.1	7.6	6.1
CA Balance (% GDP)	-5.6	-3.1	1.3	2.3
Governance Index	-2.1	-1.6	1.1	6.4
Default history (share)	-	16 %	11%	0%
Number of economies	1	43	19	41

Data source: Haver; S&P; Staff calculations.

Yields From External Bonds may be Higher Than Domestic Bonds

- **Comparable economies: San Marino (BB+) and Montenegro (B).**
- **Additional costs for external bonds:** issuing cost, carrying cost.
- **Overall cost of Eurobond:** likely higher than domestic bonds as of now, but the comparison may change in the future as domestic demand reaches its limit.

Country	Issuance Date	Maturity	Coupon	Type
San Marino (BB+)	Feb-21	3	3.3%	Eurobond
Montenegro (B)	Dec-20	7	2.9%	Eurobond
Kosovo	Oct-21	3	1.6%	Domestic
Kosovo	Aug-21	7	3.2%	Domestic

Data source: S&P; Fitch; CBK; Staff calculations.



Kosovo: Topics about Informality

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Amanda Edwards

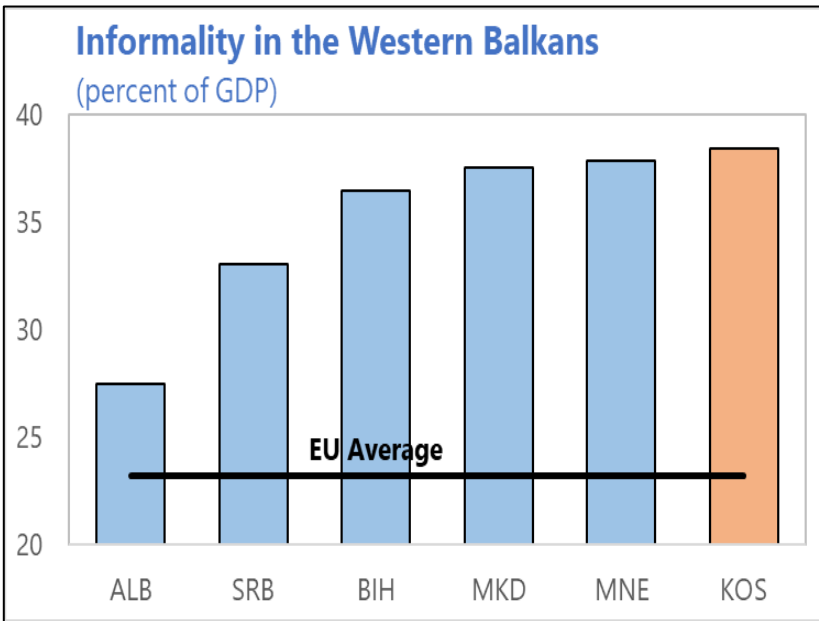
IMF Regional Representative Office for the Western Balkans

Why do we care about Informality?

- **Reduces the tax base and fiscal space for the provision of public goods.**
- **Hampers fair market competition.**
- **Limits economies of scale, access to finance and capital accumulation.**
- **Affects labor conditions, and social and customer protection.**

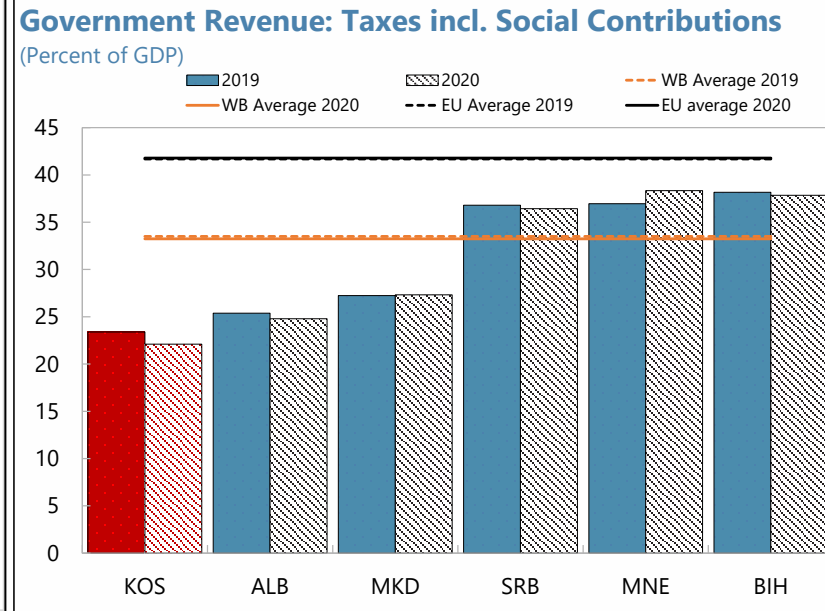
Informality in Kosovo is like in the Western Balkans, but its economic impact is higher

High informality in Kosovo...



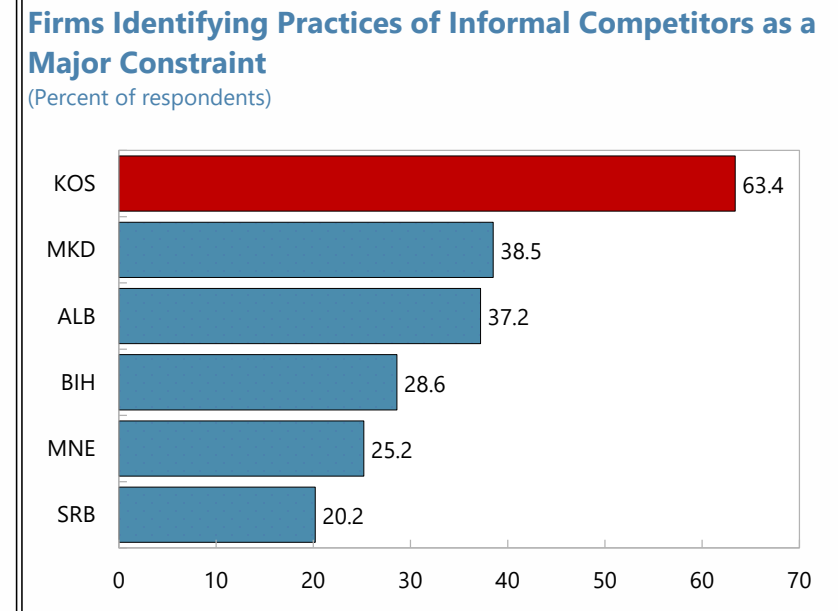
Source: IMF staff calculations; The Global Informal Workforce, Priorities for Inclusive Growth.

...results in lower fiscal revenues than in the Western Balkans...



Source: IMF WEO Oct-2021 and IMF staff calculations. Note: KOS figures don't include mandatory pillar 2 contributions of around 2.7 percent of GDP. EU weighted average doesn't include Austria, Lithuania and Malta due to data availability.

...and disproportionately affects tax compliant businesses.



Source: World Bank Enterprise Surveys 2019.

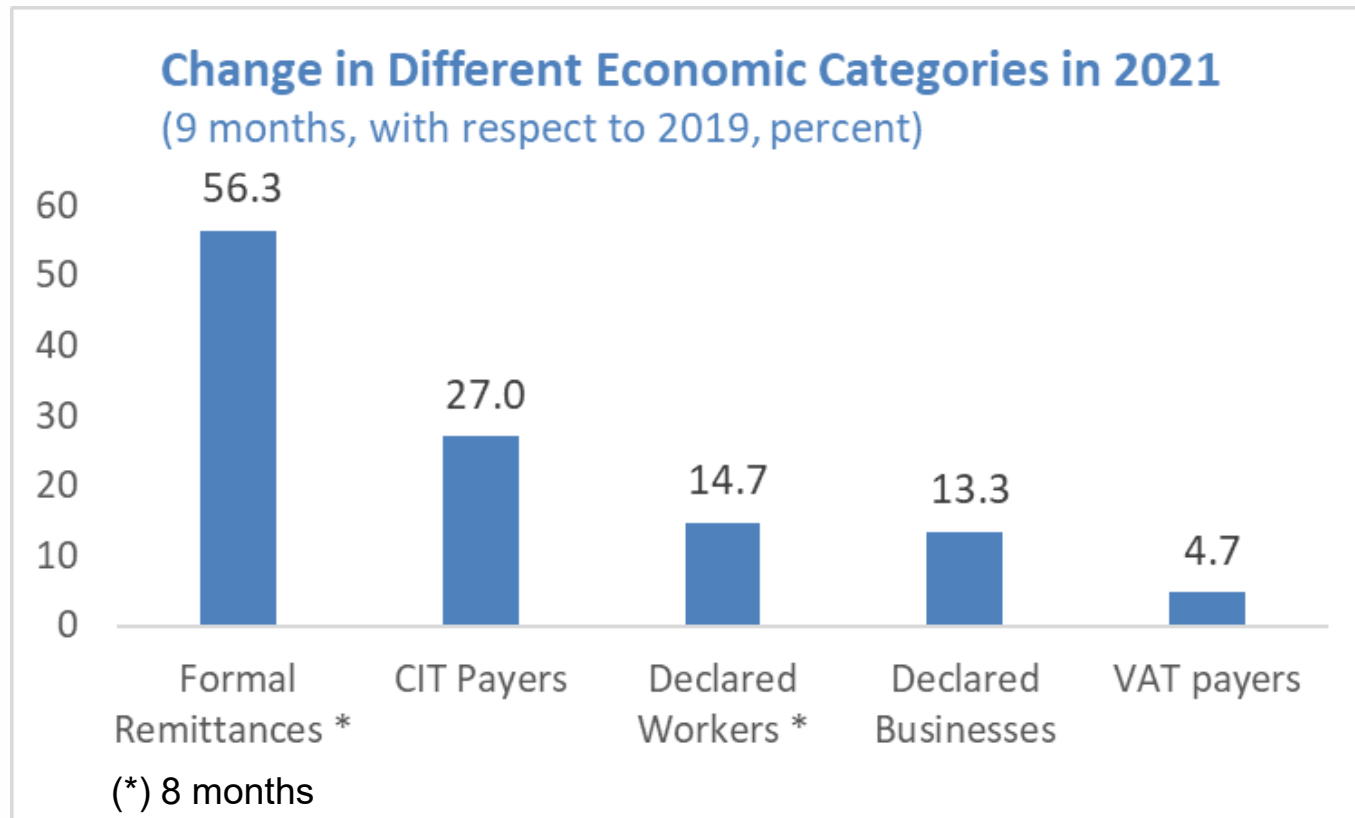
What is behind Informality in Kosovo?

Key drivers commonly cited in Surveys are:

- **Lack of trust in the functioning of the State & corruption**
 - **Prolonged litigation & inefficient justice administration**
 - **Society's acceptance of informality**
 - **Sparsely used enforcement & sanctions that reduce the cost of informality**
 - **Prevalence of cash-based transactions**
- *Kosovo's low tax rates are not considered to be a driving factor*

Sources: Article IV discussions with Kosovar authorities and stakeholders, such as Kosovo's Commission on Combatting Informality and local legal experts.; European Commission, Staff Working Document of the Economic Reform Programme of Kosovo (2020-2022), April 2020; World Bank, Western Balkans Regular Economic Report, Spring 2021; National Strategy of the Republic of Kosovo for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes (2019-2023), May 2019

Policy Actions and Mobility Restrictions led to Increases in Formalization...



Source: Central Bank of Kosovo, Tax Administration of Kosovo, and IMF staff calculations.

Increase of declared employees following ERP policies 2020-21:

Return to work of those who lost their jobs during the pandemic	1,013
Support for formalized employees	4,066
Support for women's employment	4,882
TOTAL	9,961

Source: Tax Administration of Kosovo.

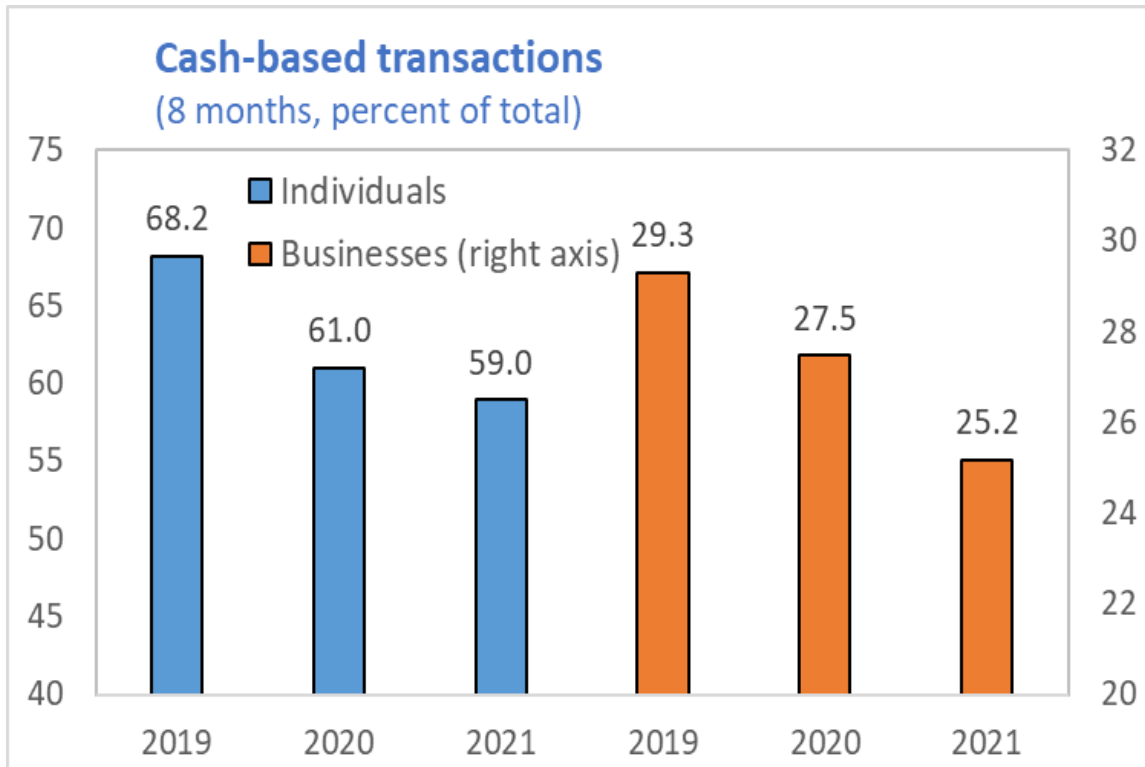
Newly declared employees due to TAK visits:

2019	2,880
2020	2,276
2021 Jan-Aug	2,762

Source: Tax Administration of Kosovo.

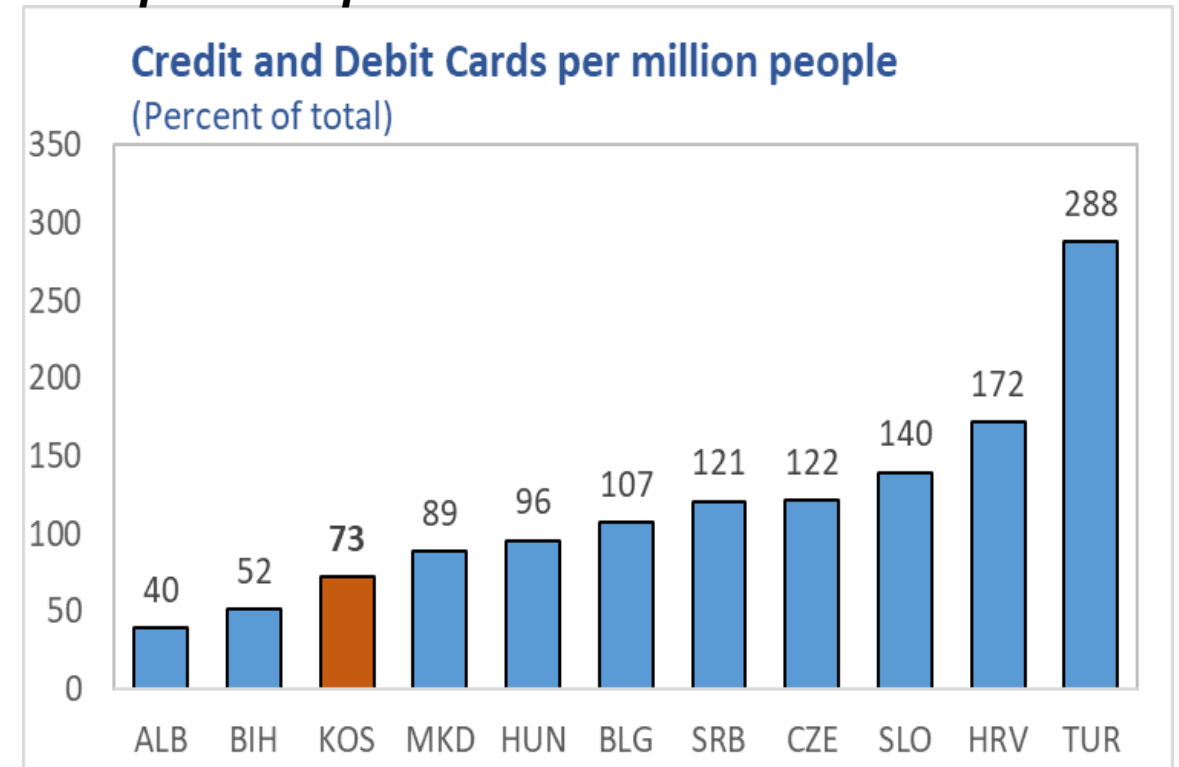
...which also supported an increase in electronic payments, despite still-low digitalization.

Cash-based transactions are declining...



Source: Central Bank of Kosovo and IMF staff calculations.

...while financial digitalization remains low compared to peers



Source: Central Bank of Kosovo.

How to sustain and increase recent formalization gains? Recommendations from IMF Research

- **Increase fairness and efficiency of justice system**
- **Simplify tax procedures, enhance monitoring and enforcement**
- **Strengthen and enhance completion of secondary, technical and vocational education**
- **Link taxes to services to raise transparency and awareness**
- **Increase financial inclusion and electronic payments**





Kosovo: Mitigating Climate Change and Protecting the Environment

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Oana Luca

IMF Strategy, Policy and Review Department

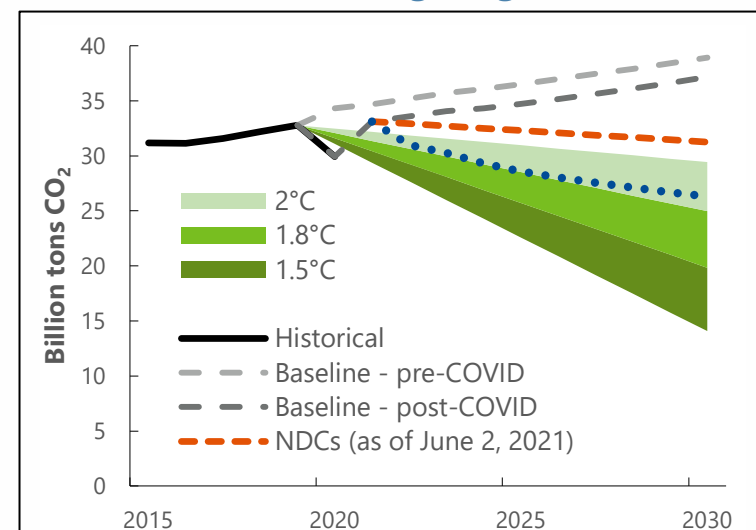
Global action to reduce GHGs is urgent

At the EU level, the **Green Deal** introduced more ambitious targets to cut GHGs by 55 percent by 2030.

At the regional level, the **Sofia Declaration** commits Western Balkan countries to introduce carbon pricing instruments and market-based renewables support schemes, as well as phasing out coal subsidies, with view to achieving carbon neutrality by 2050.

The exit from the pandemic offers an opportunity for a green recovery.

Global CO₂ Projections and Pathways for Warming Targets



Source: Parry, Ian, Simon Black, and James Roaf (2021). International Carbon Price Floor among Large Emitters. IMF Staff Climate Notes 2021/001

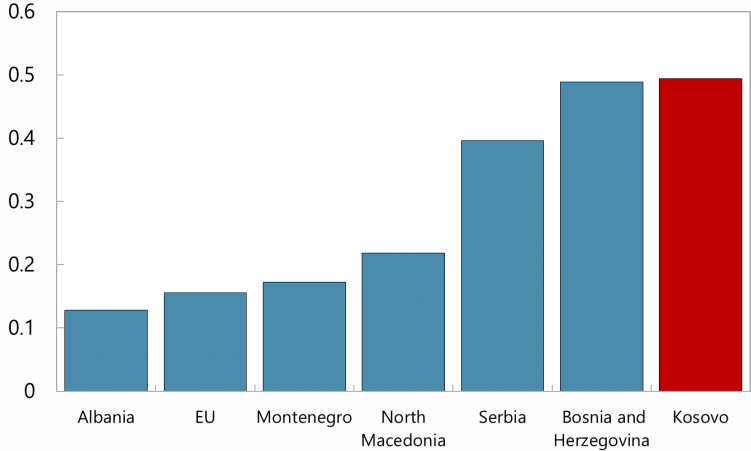
<https://www.imf.org/-/media/Files/Publications/Staff-Climate-Notes/2021/English/CLNEA2021001.ashx>

Note: Carbon tax starts at \$15 per ton, rising steadily thereafter from 2022 to 2030. Warming pathways assume CO₂ emissions are reduced in proportion to total GHGs.

Kosovo's carbon intensity is the highest in the Western Balkans

CO2 Emissions Intensity, 2016

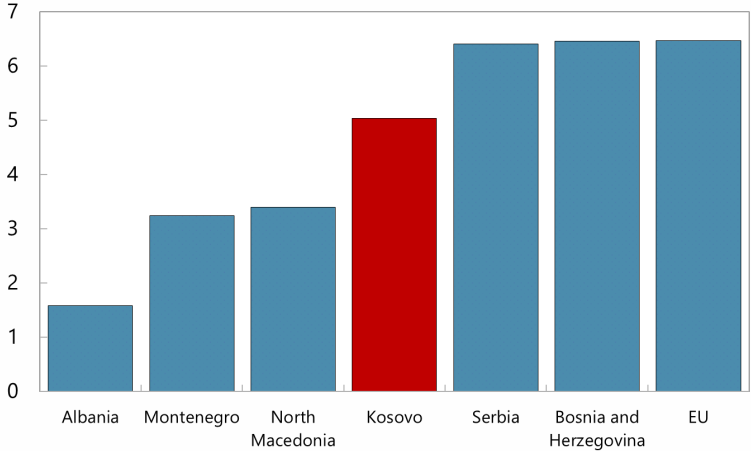
(Kg per 2017 PPP \$ GDP)



Sources: World Development Indicators.

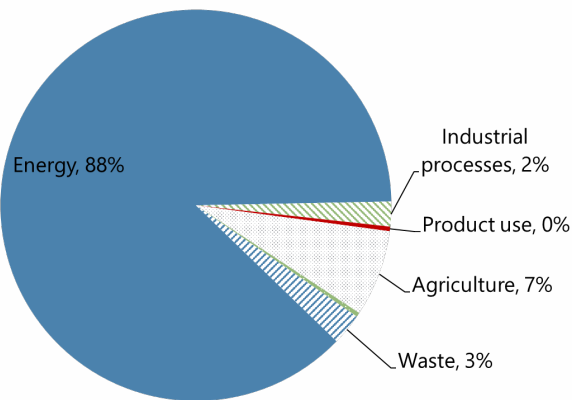
CO2 Emissions, 2016

(Metric tons per capita)



Sources: World Development Indicators.

GHG Emmissions in Kosovo, 2013



Sources: MESP 2018.

Addressing climate change and environmental pollution is macro-critical for Kosovo:

Significant health cost of air pollution (2.5 to 4.7 percent of GDP in 2016, cf WB estimates)

Energy sustainability

Commitments under the SAA and implementation of EU-related reforms

Kosovo's climate agenda and challenges

While Kosovo is not part of any international agreement on climate change, commitments derive from the SAA (2016) and membership in the Energy Community (2006)

The Climate Change Strategy 2018-2027 and the Climate Change Action Plan 2019-2021

- Sectors: energy, buildings, minerals and industry, transport, waste management, agriculture, and forest and nature conservation
- Measures on the regulatory side, but with no clear commitments, reduction targets or measures

Kosovo: A roadmap for climate change mitigation

GHG accounting. Develop an annual inventory of GHG emissions at the national level and by sector.

Sectoral targets and measures. Develop targets and policies for the key sectors (energy, industry, buildings, transportation and agriculture).

Adopt a comprehensive carbon strategy centered on **carbon pricing** and supported by sectoral feebates. Recycle carbon pricing revenues to **investment in green energy** with benefits that are equitably allocated.

Energy sector. Improve efficiency, reduce losses, introduce carbon pricing, increase share of renewables in the energy mix, mitigate effect on poor households.

Strengthen standards for air quality