Council of the
European Union

Brussels, 18 April 2018
(OR. en)

8114/18

ECOFIN 338
UEM 116
COWEB 48

COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	18 April 2018
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	SWD(2018) 133 final
Subject:	COMMISSION STAFF WORKING DOCUMENT ECONOMIC REFORM PROGRAMME OF KOSOVO* (2018-2020) COMMISSION ASSESSMENT

Delegations will find attached document SWD(2018) 133 final.

Encl.: SWD(2018) 133 final

* This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

EUROPEAN
COMMISSION

Brussels, 17.4.2018
SWD(2018) 133 final

COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

KOSOVO*
(2018-2020)

COMMISSION ASSESSMENT

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CONTENTS

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1. Executive Summary

Kosovo's economic growth is stable but new sources of growth remain scarce. The baseline scenario of the economic reform programme (ERP) is somewhat optimistic, and forecasts GDP growth of 4.7 % on average in 2018-2020, which is above Kosovo's long term average. Private consumption should remain the main driver of growth supported by remittances, rising social transfers and partially recovering employment. The projected acceleration relies on ambitious public investment plans which should drive the overall investment growth. The contribution of public consumption to growth is expected to remain subdued because of Kosovo's limited fiscal capacity following the recent increases in categorical benefits. Shortcomings in public investment execution, a weak electricity supply and political instability remain the main downside risks to the economy. The possible construction of a major new power plant constitutes an upside risk.

Maintaining fiscal sustainability and addressing large investment needs are the main public finance objectives in 2018-2020. Revenue growth is expected to rely mainly on economic growth and improved tax compliance. The projected increase in public expenditure is driven by a steep rise in capital spending. This is due to the expected start in 2018 of several infrastructure projects supported by international financial institutions (IFIs). The deficit is projected to be 3.8 % of GDP on average in 2018-2020 (1.4 % when adjusted for capital spending excluded under the fiscal rule) and public debt is set to rise to 21% of GDP by 2020. Immediate fiscal risks stem from the still unknown final cost of the war veteran pension scheme, and the persistent pressure from large interest groups for increases in entitlements and transfers.

The main challenges facing Kosovo include the following:

- **Kosovo faces numerous development challenges which call for a judicious use of its limited fiscal space.** Preserving high shares of capital spending and improving the efficiency and efficacy of current spending remains paramount. Pressures from social groups for new transfers and entitlements risk crowding out much-needed spending on health and education. Other important areas requiring the allocation of adequate resources include social assistance for the poor and infrastructure maintenance. Against this background, prioritisation, planning and coordination of different policies are essential, while new policies should be properly evaluated and costed before adoption. However, Kosovo has so far struggled to build adequate capacities for policy evaluation, macro-fiscal forecasting, budget planning, and fiscal oversight.

- **Capital projects are regularly delayed because of the weak capacity to implement projects.** On average around 15% of the capital budget remains unused every year. This is even higher at the local level and for projects funded by the International Financial Institutions (IFIs). Furthermore, the cost of large infrastructure projects is systematically underestimated in the budget, leading to a regular reallocating of funds at the expense of other smaller projects. Boosting the administrative authorities' capacity to appraise and select projects, perform multiyear budgeting, and ensure independent project assessment and auditing will be essential if Kosovo is to achieve the ambitious public investment growth envisaged in the ERP.

- **Kosovo's business environment continues to be hampered by the large informal economy**. This results in unfair competition from unregistered companies and in problems with accessing finance, which, in turn, hampers the ability of registered business to grow and innovate. Undeclared turnover and work also have negative effects on public revenue collection and workers' rights. The ERP recognises the informal economy as a problem, and proposes some measures which partially try to address it (i.e. addressing informality in the immovable property or the general inspection reform) but does not propose to address it in a comprehensive manner.

- **The unreliable supply of energy continues to be a major constraint for Kosovo's competitiveness.** Kosovan firms face the most frequent power outages in the region and there is a lot of potential to improve energy efficiency. The ERP proposes the continuation of two important measures to overcome these obstacles, including new investments in power generation (thermal and renewable sources) and energy efficiency. However, the proposed energy efficiency measures will only have a limited impact if they continue to ignore the residential sector, which is the largest consumer of electricity. The new investments in energy generation will also require a plan to gradually adjust energy tariffs to reflect new and higher costs.
- **The level of employment in the private sector is still very low.** The position of women in the labour market is marginal and is even on a declining trend. Kosovo's labour market is mostly requiring technical profiles, which the vocational education and training system does not yet deliver in sufficient quantity and quality. The education system does not provide a sufficient level of pre-primary level education, which would be an important contribution to boosting Kosovo's socioeconomic development in the longer term.

The policy guidance jointly adopted at the Economic and Financial Dialogue of 23 May 2017 has been partially implemented. Capacity constraints still hinder macroeconomic forecasting and budget planning, while no options paper was prepared for establishing a fiscal oversight body. Capacities for public procurement on local level have improved but there was no progress on limiting the costs of war veteran programmes or improving their targeting and means-testing. On the fight against the informal economy, some initial sector risk assessments have been carried out and the Strategy and Action Plan are now being reviewed and will have to be adopted. On energy, full deregulation of generation prices was achieved and some positive steps were taken towards gradual deregulation of prices for commercial consumers. However, no significant energy efficiency measures have been adopted for the private sector. The Action Plan on youth employment has been adopted and the Employment Agency has become a self-standing body.

The ERP sets out reform plans that are broadly in line with the priorities identified by the Commission. The ERP reflects the government's commitment to stable public finances and to preserving the share of capital spending. The ERP also mentions the need to support private sector development. However, recently enacted or announced fiscal policy measures are not always aligned with these goals. The ERP correctly identifies the weak quality of education and the large skills gap as major obstacles to labour market participation and employment, and to private sector development and innovation. Weaknesses in electricity supply, access to finance, contract enforcement and the large informal economy are also recognised as major impediments.

2. ECONOMIC OUTLOOK AND RISKS

The ERP projects a significantly more optimistic growth scenario than last years' programme. This scenario is supported by a more favourable external environment, more optimistic expectations of investment and exports growth, and strong credit growth. GDP growth is expected to gradually strengthen from the estimated 4.3% in 2017 to 5.1% in 2020. Private consumption growth, 4.6% on average in 2018-2020, is projected to continue contributing the most to GDP growth, despite surprisingly low contribution of private consumption of 0.4pp to GDP growth in 2017, which rather raises a question of data reliability. Disposable income is expected to benefit from stronger remittances, increased social transfers and rising employment. Public consumption should increase by 3.6% in 2018 due to new hiring in healthcare and judiciary sectors and more spending on infrastructure maintenance, but is set to remain subdued during the rest of the period. Investment growth is projected to moderate compared to double digit rates in 2016 and 2017, to around 7.6% on average. The ambitious public investment plan (17% average growth 2018-2020) rests on the strong implementation of IFI supported projects and final distribution of privatisation related funds. Private sector investment is expected to significantly contribute to growth only towards the end of the period, as the full impact of the recent improvements in business environment and the new incentive measures for domestic production takes time to materialise. Because of Kosovo's narrow export base, the recovery of export growth, which is expected to average 3.6% in 2018-2020, will primarily depend on external demand for metals, despite signs of stronger service exports and some export diversification. Expected import growth of on average 3.9% during this period seems underestimated given the historical trend and the substantial import component of investments.

Table 1:

Macroeconomic developments and forecasts

	2016	2017	2018	2019	2020
Real GDP (% change)	4.1	4.3	4.6	4.9	5.1
Contributions:					
- Final domestic demand	7.2	4.2	6.0	5.6	6.3
- Change in inventories	0.0	0.6	-0.2	0.3	0.2
- External balance of goods and services	-3.1	-0.5	-1.1	-1.0	-1.4
Employment (% change)	11.7	:	:	:	:
Unemployment rate (%) LFS	27.5	:	:	:	:
GDP deflator (% change)	0.5	0.2	1.5	0.9	1.7
CPI inflation (%)	0.3	1.7	1.3	1.1	1.2
Current account balance (% of GDP)	-8.3	-9.0	-9.5	-10.1	-10.8

Sources: Economic Reform Programme (ERP) 2018

On the production side, GVA is expected to increase by 6.8% on average during the period driven primarily by the services sector. The expected agriculture sector growth (6.9% on average) seems overoptimistic given the historical performance and marginal policy change. The construction sector (8.9% average growth) will likely remain dependent on large public investment projects. Overall, the expected growth contribution of GVA surpasses the expected growth of GDP resulting in a negative growth contribution of net taxes in 2019 and 2020. As the ERP foresees neither the large changes in tax policy nor substantial increases in subsidies this does not seem consistent with the scenario.

The baseline scenario of accelerating growth is broadly plausible, but rather on the optimistic side as downside risks stemming from investment under-execution, unreliable electricity supply and political instability represent medium term challenges. Underperformance of public capital spending is a recurrent risk due to overoptimistic planning and poor capacity for project management and implementation. In 2018, out of budget capital spending is projected to increase by 16.7%. In addition significant absorption of IFI funds and a large disbursement from the Kosovo Privatisation Agency (PAK) are planned. This might be overly ambitious given Kosovo's limited institutional capacity and poor track record in absorbing IFI funds. Furthermore a downside risk relates to the PAK disbursements which have already been postponed for several years due to administrative issues. Lower investment expectations are reflected in somewhat less optimistic growth forecasts from the IMF (4% on average in 2018-2020). Another downside risk to growth stems from Kosovo's insufficient electricity production capacities which are prone to malfunctions. While plans to build a new power plant have advanced, any supply disturbances would cause energy imports to rise, increasing costs for the electricity production and distribution companies. Political instability and reform delays could further undermine a business environment already struggling with an inefficient judiciary, weak contract enforcement, a widespread informal economy, and an inefficient and unaccountable public administration. The ERP low growth scenario takes account of these and some other potential downside risks resulting in 3.1% average growth in 2018-2020.

The announced construction of the new power plant has the potential to significantly boost growth during the construction phase and strengthen potential growth in the medium term. This upside risk is not incorporated in the baseline projection. The construction of the new 'Kosova e re' lignite fired power plant could begin in 2018 and become operational by 2023. This would be a largest individual investment in the history of Kosovo, estimated at over EUR 1 billion (around 15% of GDP), and would provide gross electrical capacity of 500 MW. A project of such magnitude will have a major impact on growth dynamics already in the short term through higher investment, although it will be partially offset by higher imports. Another upside risk comes from possibly stronger private investment following the adoption of a comprehensive reform agenda to improve doing business and provide incentives for domestic production. The ERP's high growth scenario foresees 5.8% average growth in 2018-2020. However, given the still pending financial agreement regarding the construction and operation of the new power plant, and the traditionally slow implementation of reforms in Kosovo, the balance of risks surrounding the baseline assumptions is tilted to the downside.

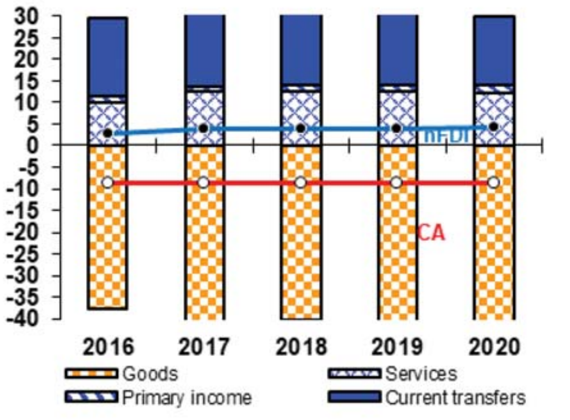
Because Kosovo is a small economy with large import components, price developments are largely determined by global commodity prices and inflation in the main trading partners. Following negative inflation in 2015 and price stagnation in 2016, inflation, rose to 1.5% in 2017, driven by food and energy prices. Core inflation stood at 1%. The ERP expects inflation to remain subdued at 1.2% on average throughout 2018-2020. This might be underestimated given the projected acceleration of GDP growth, higher inflation projections for the EU-28, 1.7% and 1.8% for 2018-2019, respectively, and the regional peers.

High trade and current account deficits reflect Kosovo's narrow production base and limited competitiveness. Current account is estimated at 9 % of GDP in 2017 but it is difficult to compare with the previous years' because of changes in methodology. Nevertheless, the trade deficit of goods and services stood at 28.4% of GDP in 2017. Net transfers (mainly remittances) were the main offsetting factor, at 19.4% of GDP. In line with expectations of higher investment and import growth, the current account balance is expected to deteriorate throughout the forecasting period to around 10.8% of GDP in 2020. Kosovo's exports still consist mostly of metals, minerals and low-value added products although the improving Herfindahl-Hirschman Index points to some export diversification.

Foreign direct investment (FDI) inflows cover part of the current account deficit but they are tilted towards non-tradable sectors. Net FDI inflows (mainly originating from the large Kosovo diaspora abroad) increased to 3.9% of GDP in 2017. However, their sectoral structure is still dominated by real estate and construction which take up over three quarters of the total. Inflows in manufacturing and agriculture were even negative pointing to weak prospects for greenfield investments in tradable production sectors. Despite the entry into force of the Stabilisation and Association Agreement (SAA) with the EU in April 2016, Kosovo's attractiveness for investors remains undermined by major weaknesses in the business environment. FDI is projected to stay at around 4 % of GDP on average thus covering only a part of the rising current account deficit.

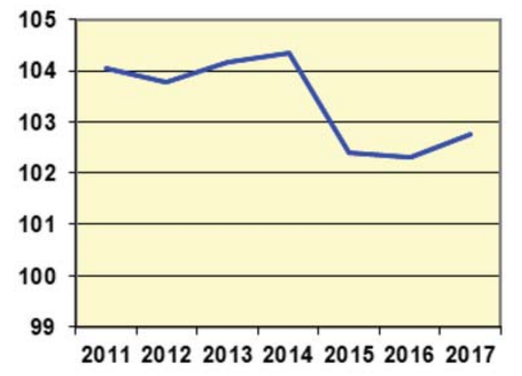
Graph 1: **External competitiveness and the current account**

Change in the current account balance (% of GDP)



Source: Economic Reform Programme (ERP) 2017, ECFIN

Real effective exchange rate (CPI-based, total economy, 2010=100)



Source: ERP 2018-2020

Despite a slight recovery of employment due to continued growth, Kosovo's labour market conditions remain a serious concern. In the first three quarters of 2017 employment grew by 9.7% compared to the same period in 2016 bringing the employment rate to 29.7%. However, due to an increase in labour force participation the unemployment rate increased by 3.3 percentage points to 30.4% in the same period. The ERP does not provide forecasts for employment growth or the unemployment and activity rates; however with a large annual inflow of young people to the labour force and so far modest growth in employment, so far major changes in the labour market outcomes can hardly be expected. The proportion of long-term and unemployed young people is likely to remain high. The potential risk to the already weak labour market outcomes comes from the initiative to raise the minimum wage from EUR 170 (EUR 135 for young workers) to EUR 250 euro. Despite minimum wage not being adjusted from 2011 a 38 % real increase (around 74% for youth) could be detrimental to the employment of low-skilled workers.

The banking sector remains stable, liquid and profitable, but also heavily under-utilised. In 2017 Kosovo experienced the strongest credit growth (11.5%) since 2011. This was driven by demand from both households and businesses and supported by the easing of credit standards and lower loan interest rates for loans. The loans to deposits ratio increased by 3.5 percentage points to 80.4% in December 2017. The banking sector remains underutilised (total loans represent 39.3% of GDP) as mortgage lending is poorly developed and widespread informality excludes businesses from financial markets. Banking-sector risks remain contained. Non-performing loans (NPLs) reached a record low of 3.1% and are fully provisioned. The banking sector increased its profitability (21.3% return on equity in 2017 compared to 18.5% in 2016). The ERP again does not provide numerical forecasts for the financial sector. It can be assumed that credit growth would accelerate as private consumption and investment are expected to be the main drivers of growth.

Table 2:

Financial sector indicators

	2013	2014	2015	2016	2017
Total assets of the banking system, mEUR	3,059	3,187	3,387	3,637	3,877
Credit growth	2.4	4.2	7.3	10.4	11.5
Bank loans to the private sector %	50.5	44.9	41.5	40.0	
Deposit growth	7.5	3.6	6.5	7.2	6.7
Loan to deposit ratio	78.0	74.9	75.3	78.4	79.7
Financial soundness indicators					
- non-performing loans	8.7	8.3	6.2	4.9	3.1
- net capital to risk weighted assets	16.8	17.8	19.0	17.9	18.0
- liquid assets to short-term liabilities	48	43.6	44.9	41.5	38.2
- return on equity	9.4	20.2	26.4	18.5	21.3
- forex loans to total loans	0.0	0.0	0.0	0.0	0.0

Sources: National Central Bank

3. PUBLIC FINANCE

The sustainability of public finances was preserved in 2017, despite a significant underestimation of war veteran spending. Strong economic growth and better revenue collection contributed to revenue growth of 5.2% in 2017 compared to 2016. Revenue from indirect taxes grew by 7.2% adding to evidence of strong consumption growth. Only municipal revenue slightly underperformed as local elections caused delays in service provision. Budget expenditure slightly underperformed compared to the budget plan (95% of the plan) but still grew 4.9% compared to 2016. While overall current expenditure growth was contained, the costs of the war veteran pension scheme reached 1% of GDP instead of the projected 0.7 % as the number of certified recipients turned out to be significantly higher than expected. The share of capital spending increased for a second consecutive year to 26.9% of total expenditure (7.4% of GDP), despite lack of any disbursement by the IFIs. The overall deficit stood at 1.2% of GDP[1], and the fiscal rule adjusted deficit stood at 0.7% of GDP, well below the 2% ceiling.

Maintaining fiscal sustainability and addressing large investment needs are the main public finance objective in 2018-2020. The 2018-2020 budget framework predicts a 7 % average growth in revenue, with a stronger growth in 2018 (8.3 %) and moderation after that. Direct taxes are projected to grow on average 10% annually, due to a broadening of the property tax base resulting from the introduction of the new tax on land. Indirect taxes are expected to increase on average 6% with the largest contribution coming from the VAT and the announced increase in excise duties on tobacco. Non-tax revenue is projected to stagnate throughout the period owing to the announced streamlining of administrative fees. Similarly

[1] The text comments on actual 2017 budget execution while the ERP at times reports the expected deficit according to the 2017 revised budget

expenditure is expected to rise 19.7 % in 2018 and 4.8 % on average after that. The large increase results from IFI-funded infrastructure projects which are expected to begin in 2018. The resulting budget deficit should stand at an average 3.8 % of GDP and 1.4% of GDP using the methodology of the fiscal rule (see next paragraph). Public debt should steadily rise to 20% of GDP by 2020 while government deposits used as fiscal buffers should remain at the legally required level of 4.5 % of GDP on average.

Kosovo's strengthened rules-based fiscal framework should contribute to fiscal stability while safeguarding high out-of-budget capital spending. The main pillars of the fiscal framework are the adjusted deficit rule (2% of GDP) and the debt ceiling (40% of GDP). To create sufficient fiscal space for addressing the large infrastructure needs in a fiscally sustainable manner, capital expenditure funded by concessional IFI financing and from privatisation proceeds is deducted from the deficit[2]. To safeguard against ad-hoc increases in current spending two expenditure rules were introduced in 2016 and 2017. To avoid large increases in public wages which occurred in previous election years, the growth rate for the annual wage bill has been limited to the nominal GDP growth rate starting in 2018. Furthermore the amendment to the law on war veterans limits the expenditure on war veteran pensions to 0.7% of GDP annually. Enforcement of this limit is however pending on completion of the reclassification of beneficiaries. The efficiency and efficacy of current expenditure in Kosovo are low as spending increases have so far been dominated by short sighted, ad-hoc rises in public wages, pensions and other transfers and subsidies, very few of which were targeted or means tested. Given the strong pressures to increase current spending and large spending needs on health and education, and investments, the available fiscal space needs to be clearly prioritised. In this regard Kosovo could benefit from establishing Medium Term Expenditure Framework (MTEF) that would support better expenditure prioritization and planning. Furthermore, Kosovo could benefit from creating a fiscal body to oversee the implementation of the budget, assess policy proposals and contribute to the debate on fiscal policy.

Table 3:

Composition of the budgetary adjustment (% of GDP)

	2016	2017	2018	2019	2020	Change: 2017-20
Revenues	26.5	27.2	27.1	27.2	27.1	0.0
- Taxes and social security contributions	24.0	24.3	24.4	24.7	24.9	0.6
- Other (residual)	2.5	2.9	2.7	2.5	2.3	-0.6
Expenditure	27.6	28.5	31.1	30.6	30.1	1.6
- Primary expenditure	27.2	28.2	30.7	30.3	29.8	1.7
of which:						
Gross fixed capital formation	7.3	7.9	10.3	10.5	10.8	3.0
Consumption	12.3	12.8	12.7	12.4	12.0	-0.8
Transfers & subsidies	7.8	7.8	7.8	7.5	7.0	-0.8
Other (residual)	-0.3	-0.3	-0.1	-0.1	-0.1	0.2
- Interest payments	0.4	0.4	0.4	0.3	0.3	-0.1
Budget balance	-1.1	-1.4	-3.9	-3.4	-3.0	-1.6
Budget balance as per fiscal rule	-0.9	-0.7	-1.8	-1.5	-0.9	-0.2

[2] These exceptions apply while the overall debt level is below 30% of GDP and the government deposits are above 4.5% of GDP.

Primary balance	-0.7	-1.0	-3.6	-3.1	-2.7	-1.7
Gross debt level	14.0	15.8	17.6	19.2	20.0	4.2

Sources: Economic Reform Programme (ERP) 2018, ECFIN calculations

The budget revenue projections for 2018 are slightly ambitious and the budget foresees a large increase in capital spending. The 2018 budget, adopted by the Kosovo Assembly in December 2017, aims at a fiscal deficit of EUR 122 million or 1.8% of GDP[3], in line with the fiscal rule. The budget is based on nominal GDP growth of 6.2%. Total revenue is expected to be 8.3% higher than the outcome in 2017. With the only new revenue measure planned being the increase in excise duties on tobacco, significant contribution to revenue growth is expected from improvements in revenue collection and increased economic activity. In this regard, the key challenge is to preserve broad tax base through limiting losses from tax exemptions and tax evasion. Expenditure is forecast at 19.7% higher than the outcome in 2017. Current expenditure is expected to increase by 8.2%, mainly due to the agreed 4% rise in public wages and the need for new hiring in education, health and judicial sector, and a 20% increase in social welfare benefits. A substantial increase in goods and services spending (18.3% y/y) partially concerns much-needed higher spending on infrastructure maintenance. Foreseen improvements in health care service are expected to yield higher payments for pharmaceuticals and medical supplies. The forecasted growth in expenditure is mainly driven by capital spending which is ambitiously planned to increase by 48.3% in 2018. The increase is mainly due to the announced investment projects financed by IFIs (0.9% of GDP) and from the expected proceeds from privatisation (1.3% of GDP).

The ERP presents few new fiscal initiatives and focuses on the implementing already ongoing ones. On the expenditure side work to introduce a mandatory health insurance system is continuing. Collection of premiums for public sector employees is expected to start in 2019 along with the payments of contributions for exempted individuals. However these costs have not yet been included in the medium-term fiscal framework. The announced 20% increase in social welfare payments seems appropriate given the high poverty rate in Kosovo. Unlike the majority of transfers to the population, the scheme is well targeted and means-tested. The same cannot be said for agricultural subsidies which have not exhibited a strong connection to productivity gains in the sector. Nevertheless the government expects subsidies to lead to growth in agriculture productivity in 2018-2020 without any significant policy change in policy compared to previous years.

Table 4:

Composition of changes in the debt ratio (% of GDP)

	2016	**2017**	**2018**	**2019**	**2020**
Gross debt ratio [1]	**14.0**	**15.8**	**17.6**	**19.2**	**20.0**[4]
Change in the ratio	1.2	1.7	1.9	1.5	0.8
Contributions [2]:					
1. Primary balance	**1.1**	**1.4**	**3.9**	**3.4**	**3.0**
2. Snow-ball effect	**-0.2**	**-0.2**	**-0.6**	**-0.6**	**-0.9**
Of which:					
Interest expenditure	0.4	0.4	0.4	0.3	0.3

[3] This figure refers to the deficit calculated according to the fiscal rule which excludes from the fiscal balance some parts of capital spending (see more details above)

[4] The ERP document at different points puts the debt-to-GDP ratio in 2020 at 20% and 21%

Growth effect	-0.5	-0.6	-0.7	-0.8	-0.9
Inflation effect	-0.1	0.0	-0.2	-0.2	-0.3
3. Stock-flow adjustment	**0.3**	**0.6**	**-1.5**	**-1.3**	**-1.3**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accru

Source: Economic Refrom Programme (ERP) 2018; ECFIN calculations

Significant public finance challenges need to be addressed to make public spending more growth-friendly. Underestimating current expenditure and overestimating capital spending are the main fiscal risks in 2018-2020. Spending on war veteran benefits will again turn out higher than the legally prescribed limit of 0.7 % of GDP unless the number of certified veterans is decreased irrespective of the reclassification process. So far the government has not expressed any willingness to do this and around 3000 new applicants are currently awaiting certification. On the other hand, underspending of the planned capital budget is likely. Investment worth around 6.9% of GDP is planned to be financed by the IFIs and from privatisation proceeds in 2018-2020. Although the projects concerned have been incorporated in the 2018 budget they are still in different stages of preparation and their implementation will likely spread over a longer period. Disbursements of proceeds from privatisation by the Privatisation Agency, mainly allocated to the Route 6 highway project, could be delayed for administrative reasons and because of incomplete judicial processes. In that case funds for other smaller projects might then have to be reallocated to the Route 6 project. This uncertainty creates disincentives and conflict-of-interest issues and disincentives to implementing sometimes more important local projects. The potential introduction of an early retirement scheme for policemen, which has been under discussion, constitutes another fiscal risk. This scheme would also set a dangerous precedent for other professions, potentially creating additional liabilities and squeezing funds available for investment. Nevertheless, under the fiscal framework fiscal stability should be maintained in the near term. In the medium term, implicit risks to public finances are related to contingent liabilities arising from poor performance of state owned enterprises. In this regard a large investment through public private partnership into a new power plant could create an additional challenge.

Public debt is low but increasing gradually. Public debt including guarantees stood at 16.4 % of GDP at end-2017, up 2 pps. from 2016. Around 55% of the debt is domestically issued, in the form of short-maturity treasury bills and bonds, while the rest is mainly held by the IFIs. With an unadjusted deficit of 3.8% on average over 2018-2020, the debt level is expected to reach 21% of GDP by 2020. The average weighted interest rate is projected to gradually decline to 1.6% in 2020 from 2.7 % in 2017. Gross financing needs will stand at around 9.3% of GDP throughout 2018-2020, 80% of which is expected to be accommodated on the domestic market. Only the debt taken on the basis of the 'investment clause' will come from external sources. The average maturity of the domestic debt increased to 24 months at the end of 2017 compared to 15 months in 2016, as Kosovo has issued debt with longer maturities more regularly, including the first ever issuance of a seven year bond in 2017. Kosovo still does not have access to international debt markets due to the lack of an international credit rating and the relatively large fixed costs involved. An adequate fiscal buffer is provided by government deposits which were further increased to 5.3% of GDP in 2017 and are projected to remain at the level implied by the fiscal rule (4.5% of GDP) throughout 2018-2020.

4. STRUCTURAL REFORMS

The unreliable, and health hazardous energy supply, a very large informal economy (estimated at 31% of GDP), the weak rule of law, corruption and the labour market mismatch continue to be the key obstacles to improving competitiveness, employment and social development. The energy sector suffers from outdated production capacity, low energy efficiency, a non-liberalised energy market and a tariff system that does not reflect real costs. The informal economy distorts competition, and reduces public revenue collection and workers' rights. Low educational attainment levels of the working age population and higher education degrees not matching labour market needs impede labour market matching despite the large working age population. The ERP properly identifies these and other constraints to growth. The difficulty of accessing finance is not seen as a key structural obstacle anymore. While conditions have improved, obtaining finance remains a major constraint, especially for start-ups and microenterprises.

The reform measures included are mostly rolled out from last year's ERP (17 out of 20) and overall respond to the challenges identified. This shows stability and consistency of the government's medium-term economic planning. Some areas are given more focus by including more than one measure, including the energy market, the agricultural sector, the business environment, trade and education and skills. This is broadly justified by the severity of the problems and/or the sector's potential. Most of the measures directly tackle important economic challenges, such as the poor quality of education, the large informal sector, a problematic energy supply and inefficiencies in the agricultural sector. Moreover, the ERP has an increased coverage of informality and youth unemployment, which is in line with the policy guidance jointly adopted in May 2017. While one measure was fully implemented, another one was dropped without justification. There is an adequate mix of legislative, administrative, and infrastructure reforms. Budget contributions are planned for all but one measure, but in some cases the budget allocation is not consistent with the ambition of the reform. The budgetary impact of the measures during the three year period is high, although many measures are co-financed by IFIs or donors. The 2017 Commission assessment was only partially taken into account.

Public finance management

Despite a relatively solid strategic framework, Kosovo's public finance management (PFM) system still faces challenges, notably when it comes to implementation, external and internal control and public procurement. Public procurement is still characterised by low transparency. This inhibits competition and makes public procurement vulnerable to corruption. The lack of transparency negatively affects the capacity of small and medium-sized enterprises (SMEs) to compete for public contracts and reduces confidence in state institutions. The ERP highlights the weak transparency, efficiency, integrity and accountability and weak oversight of the implementation of public procurement, but it does not elaborate on the important shortcomings linked to the non-functioning remedy system and the limited capacity of the Central Procurement Agency. The ERP suggests public procurement as the main barrier to competitiveness. While the analysis of the overall PFM system recognises the importance of a healthy (external and internal) control it does not elaborate on the essential role of managerial accountability, sound risk management and an effective implementation of financial control at all levels of the administration and publicly owned enterprises.

The implementation of the measure to improve public procurement by applying electronic procurement advanced slowly. Most notably, the use of e-procurement became mandatory for all contracting authorities, but this has not yet been fully implemented, in particular by the Central Procurement Agency. Moreover, only a limited number of modules of the e-procurement system are in place and other significant issues such as oversight and monitoring of contract management have not yet been implemented. The measure could help reduce costs and increase transparency, with positive effects for companies and for the economy's overall competitiveness. However, the proposed activities for 2018 and 2019 in this year's ERP were initially to be implemented in 2017. Such delays are worrisome. The introduction of capacity building for economic operators, in addition to the procurement officers, is welcome. This should help to ensure the system does not discourage competition, which is especially important considering the still very low percentage of electronic bids submitted by SMEs.

Energy and transport market reform

Kosovo's unreliable energy supply and the dysfunctional energy market continue to hamper its competitiveness and the transport infrastructure is poorly maintained. Outdated and highly polluting energy production capacities and big distribution losses due to poor infrastructure result in the supply of energy being unreliable. The lack of incentives to consume electricity efficiently further increases the costs. The energy market is not functioning on free market principles and tariff subsidies hinder efforts to improve the competitiveness of the business sector. The ERP properly acknowledges these problems, but does not sufficiently recognise the importance of pending regulatory reforms, like the final adoption of Kosovo's energy strategy and action plan, or the capacity building of the Energy Regulatory Office (ERO). In transport, the ERP also highlights the inadequacy and poor maintenance of roads and railway networks as main weaknesses but does not cover other challenges such as recent cuts in railway services hampering the use of this form of transport.

The measure reducing energy consumption through energy efficiency measures is not ambitious enough to have the intended impact on competitiveness. Implementation is also lagging. There are no specific targets for savings, and the measure does not give any proper assessment of the expected impact (only limited estimations are provided of energy savings from the activities supported by the World Bank). Future activities have been expanded to include the adoption of a legislative framework for energy efficiency and the evaluation of financing mechanisms. This is positive, but considering the importance of energy for Kosovo's economy, the measure needs to be more ambitious. As they stand the planned energy efficiency investments still focus exclusively on public buildings. They ignore the residential sector which is the largest consumer of energy in Kosovo and neglect the policy guidance adopted at the joint Ministerial meeting in 2017. On the other hand, other activities could be removed as they are not really linked to energy efficiency (i.e. construction of a biomass power plant in Gjakova).

The measure to further develop energy generation capacity has seen some progress in 2017, but it does not mention the important risks associated with its implementation. The activities planned in 2017 advanced, notably with the signing of the technical and commercial agreement to build the Kosova e Re power plant. For the coming years, however, no consideration is given to the important risks that go with the plant's financing, construction and possible environmental, social and fiscal impact. The new investments will also require a plan to gradually adjust energy tariffs to reflect actual costs and to assess potential mitigation mechanisms to minimise the impact on the poor and vulnerable in a fiscally sustainable manner. Of the 33 small hydro power plants to be built by 2020, only one of them meets EU environmental standards.

Sectoral development

Agricultural sector development

Although Kosovo's agricultural sector represents 13.4% of gross value added in 2016, it still suffers from low productivity and low added value. The ERP's diagnostic highlights the main obstacles to the sector's competitiveness, i.e. the fragmentation of agricultural land, the small size of farms, the poor irrigation infrastructure, the dysfunctional links between primary producers and processors and the market and the lack of specialization. However, it does not sufficiently recognise the importance of addressing the problems of the agricultural sector as an integrated system, with a value chain approach. It also does not analyse the persistent obstacles hampering the proper use and consolidation of agricultural land (such as property issues, use of agricultural land for construction, cultural perceptions etc.).

In this context, the measure on investments in agricultural infrastructure and agro-processing are relevant and could help to increase productivity in the sector. However, given that the planned activities are too vague, it will not be possible to assess them next year; thus, the reform measure should set clear targets, notably the expected reduction in agricultural imports, the expected growth of exports and increase in the percentage of irrigated land per year. The focus continues to be on the provision of subsidies in the current system, but its impact in the overall agricultural sector can only be limited unless real progress is made in managing land, investing in farmer's knowledge and improving agro-food standards.

The measure to regulate and consolidate agricultural land continues to suffer from a vague definition. Neither baseline data are provided, nor the expected results (increased percentage of consolidated arable land) to be achieved each year. As such, it is not possible to estimate the scope, ambition and expected impact of this reform. The expected impact on the economy's competitiveness should be quantified to better understand the scope of the measure.

Industry sector development

Kosovo’s industry is characterised by low added value and low diversification. The sector is dominated by micro and small and medium sized enterprises with a low level of integration in global value chains in the domestic and export markets, little innovation and not much FDI. The ERP diagnostic correctly points out the lack of product quality, weak cooperation among companies, low production capacities and low skilled labour force as key underlying problems. But it still does not elaborate on the lack of a comprehensive policy framework, the structural problems affecting the support services for SMEs, such as the inadequate inter-ministerial coordination, or the insufficient capacity of responsible institutions like KIESA. It also does not refer to the problem that start-ups and micro enterprises have of accessing finance.

The measure to boost private sector competitiveness by supporting industrial SMEs is an expanded version of the measure to develop industrial clusters in the 2017-2019 ERP. Clearly, closer cooperation between SMEs, more dialogue between the public and private sector, integration in global value chains and improved access to finance are central to an economy's competitiveness. However, the scope of this reform is too broad and lacks clear targets. Illustrative of this is the fact that only very limited progress was made in the activities planned for 2017. The future activities include a good combination of legislative and analytical work together with practical support to SMEs. However, overall they are vaguely described and do not contain any specific targets to monitor their progress. It is also not clear whether the resources allocated are sufficient to achieve the expected results, especially since the reform measure relies mostly on resources allocated to KIESA, and the ERP mentions these resources will decrease by over 28% in 2019 compared to 2018.

Service sector development

The service sector contributes 57.3% of gross value added, and it is the fastest growing export sector. The ERP, however, again does not provide any proper analysis of the services sector as a whole and merely refers to general figures of trade in services, identifying only some obstacles in the tourism sector. The situation of other services such as ICT, retail and wholesale trade and professional services is not mentioned. Also, major obstacles to developing the services sector such as a lack of skills, the incomplete legal framework and an inadequate system of mutual recognition of professional qualifications are not analysed.

The measure to develop tourism products in Kosovo's tourist regions is not ambitious enough to have a significant impact on the economy. The measure continues to reflect several of the deficiencies mentioned in last year's assessment, which partly explains the limited progress that was made in the activities that had been planned in 2017. This was notably the case for improving the policy framework. The planned activities continue to suffer from a lack of strategic vision for the tourism sector. Moreover the resources allocated (only EUR 10 000 annually from the Kosovo budget) reflect a lack of real commitment to this measure for it to have any significant impact on the competitiveness of the economy as a whole.

Business environment and reduction of the informal economy

Kosovo has made good progress on improving the business environment, but some important structural challenges remain. Unfair competition from the informal sector, weak rule of law, corruption and access to finance continue to be among the main challenges to private sector development and to competitiveness. In 2017, several important regulatory reforms improved the business environment (notably to start a business, get credit and resolve insolvency), making Kosovo jump from 60th to 40th place in the World Bank's *Doing Business* report. Indeed, access to finance has improved, but SMEs still face obstacles linked to asset register-related issues and the lack of alternative sources of funding. Also, micro enterprises and start-ups continue to face serious difficulties accessing finance. The ERP acknowledges the persistence of other negative features of Kosovo’s investment climate, such as informality, slow and inconsistent contract enforcement, weak property rights and financial reporting and an uncoordinated and costly market surveillance system.

The ERP includes four measures to improve the business environment and tackle informalities. Three of them are rolled over from the 2017-2019 ERP while one is new. The adoption of evidence-based policies and reduction of the administrative burden only has a weak link to private sector development and competitiveness. The proposed activities could be much more specifically geared to the private sector and less generally applicable to public administration reform. As mentioned above, Kosovo has made very good progress in reducing the administrative burden linked to starting a business, getting credit and resolving insolvency. However, these improvements are not necessarily the result of the activities implemented under this measure in 2017.

The measure to secure property rights by addressing informality in the immovable property sector has advanced with the preparation of critical laws. Most of these laws are expected to be adopted in 2018. If achieved and duly implemented, these legislative changes could have an important impact on securing property rights, unlocking access to finance, and facilitating the settlement of disputes. These are all essential to provide legal certainty and attract local and foreign investment. It can also have a positive gender dimension, helping women to enjoy equal property rights and facilitating their economic independence. The reform measure is ambitious but its successful implementation will require continued strong political backing to push the reforms through, which is recognised in the ERP.

The implementation of the measure to increase judicial efficiency by reducing the backlog of court cases has been lagging for the past 2 years. The reform continues to be highly relevant and the adding of clear targets for the recruitment of judges and professional associates is positive. However, it is not clear if there are plans to address systemic issues on case management processes and practices in the courts, which hamper efficiency. Addressing those obstacles will be important to achieve the expected results. This is especially the case considering that the introduction of an electronic case management system will not include old cases and therefore its use for monitoring and managing the backlog will be limited.

The measure on the general inspection reform is new and can be relevant to address the unnecessary burden to businesses that frequent, uncoordinated and costly inspections represent. However, the diagnostic on the business environment does not provide sufficient information about the magnitude of the problem and its effect on businesses. Some important activities for the success of the reform have also not been sufficiently developed, for instance screening of sectoral laws and secondary legislation to align them with the new law on inspection; the implementation of the electronic data management system; or the need to sufficiently equip market inspections).

Two measures in last year's ERP in this area have been dropped. The full operationalisation of the Kosovo Credit Guarantee Fund was successfully implemented in 2017. The fund is now operational, and loan guarantee schemes have been agreed with most commercial banks operating in Kosovo. However, the measure to merge the Kosovo customs and tax administrations and establish a single Revenue Collection Agency was dropped without any justification.

Research, development and innovation and the digital economy

Kosovo's capacity to engage in research, development and innovation (RDI) is very low and faces important challenges linked to RDI policy governance, the involvement of the private sector in RDI and cooperation between business and academia. This reduces the ability of SMEs to create new competitive products and services. The ERP analysis recognises the lack of a legal and policy framework and the low level of political commitment to RDI, which is reflected in the very low public expenditure (0.1% of GDP). The analysis also adequately signals the lack of incentives for the private sector and academia, and the limited extension of the broadband internet infrastructure which affects productivity and competitiveness.

The measure to improve entrepreneurship and the innovation environment (renamed from the 2017-2019 ERP) has experienced delays, in particular the delay in adopting the new law and strategy. The budget dedicated to this measure, which would directly support SMEs to become more innovative, is large and would undoubtedly support competitiveness if implemented. The measure's expected impact however, will only be achieved if it is complemented by more ambitious activities to assist and boost applied research activities in higher education, to substantially improve cooperation between research institutes and businesses and embed the measure into a wider smart specialisation strategy.

The measure to extend the ICT network infrastructure showed almost no progress in its implementation. The activities planned for 2017 have been carried over again in 2018. In 2019 and 2020, the reform now includes activities to develop human capacities and support digital business, but several of these actions are still rather general and do not include any specific targets. The activities should be quantified so that the implementation can be monitored properly. Traditional industries' support for digitalisation is not quantified and therefore it is difficult to estimate its potential impact. Moreover, in the past 2 years the ERP assessments highlighted the need to complement infrastructure investments with increased competition between operators and regulator independence. However, these have still not been addressed. To achieve the expected impact, the expansion of the ICT infrastructure should also be accompanied by the development of e-skills at different levels, from primary schools to vocational training. Finally it is not clear whether last year's Commission recommendation to review the definition of broadband in the KODE (from 512 kbps to e.g. 10-30 Mbps or higher) has been taken into account, and a clear target for the expected increase in the penetration rate is still missing.

Trade-related reforms

Kosovo remains poorly integrated in the global economy, with exports of goods and services representing only 22.5% of GDP in 2016. Kosovo's trade of goods is dominated by imports which are likely to increase further because of large infrastructure investment. While export diversification has moderately improved, the country mainly relies on a few basic products such as minerals and metals. Obstacles to trade openness include the high administrative costs linked to procedural, quality, logistical and border barriers, which reduce the level of exports and increase the price of imports. This is coupled with an underdeveloped quality infrastructure. The ERP fully recognises these challenges but the critical importance of engaging with the private sector and developing expertise in marketing and sales is not sufficiently considered.

The measure increasing the cost efficiency of international transactions (by simplifying and standardising border formalities and procedures) showed good implementation progress in 2017. However, there is still no proper analysis of the measure's expected impact on competitiveness (i.e. estimated reduction in time and costs for businesses to export). The budget for this measure is still very limited (EUR 10 000 per year) and the activities are expected to be supported by donors (although the level of support and overall cost of the measure is not clear). In terms of risks, the introduction of non-tariff barriers to 'protect' local manufacturers would undermine the measure's impact.

The measure on further development of quality infrastructure has been expanded to also cover stronger market surveillance. Both are highly relevant and central to implementing the Stabilisation and Association Agreement. The new activities included this year have a better combination of legislative development, and support to manufacturers to comply with EU standards. However, the activities to improve market surveillance are too limited to have a meaningful impact, and the scope of the support to companies is not clearly defined. Some of the deadlines seem rather ambitious. Overall, the expected impact of the measure is only very broadly analysed, and in spite of having a particular focus on one sector (construction) it does not contain any specific targets (i.e. import substitution or increased exports planned as a result of the activities to be developed). This limits the potential impact and makes it difficult to monitor implementation. There is concern that the activities planned in 2017 have only been partially implemented and the continued lack of qualified staff and financial resources within the responsible agencies poses a major risk. While this is mentioned as a risk, no mitigating measures have been considered.

Education and skills

Improving the education system from pre-primary to higher education remains a paramount challenge and key factor in Kosovo’s socioeconomic development. Due to historic low levels of participation, the educational attainment of the labour force is still very low; around 40% of working age population has no education beyond primary. The increased participation in education will over time raise attainment levels. In 2015-16, enrolment reached 95.6% in (compulsory) primary and 84.9% in secondary education. Some progress was made in closing the gaps in pre-school education. In 2016-17, the enrolment rate was

85.5% for children aged 5-6 (+5.9pps compared to 2014/15) and 46.6% for children aged 4-5 (+5.7pps), however this coverage remains far below European standards (EU2020 benchmark of 95%). The overall coverage of children up to 5 years is as low as 3.5% (2015-16).

The measure revising occupational profiles and standards and adjusting curricula in vocational education and training (VET) requires a stronger cooperation between public and private sector. Reforms in VET should indeed be prioritised, since job creation in Kosovo is mostly in jobs requiring these profiles. The activities planned in 2017 were only partially implemented. The reform would also need to be complemented by a skills intelligence process with skills needs analysis in sectors that have been prioritized in other ERP measures (woodworking, metal processing, textiles, tourism, etc.). The ERP does not reflect the overall budgetary impact of the reform nor include the substantial donor support Kosovo is supposed to receive to support VET reforms.

The measure for licensing and evaluation of teachers in pre-university education should put more focus on teacher training for the roll-out of new school curricula. This should include speedily making textbooks available, and putting in place mechanisms for ensuring effective classroom implementation. The budgetary impact of the new career system for teachers remains unclear; the retirement of large numbers of teachers in the coming years calls for a strategic approach to ensuring school education.

The long-pending amendment of the law on higher education should be completed without further delay in 2018. Kosovo should ensure that its domestic approach to quality assurance in higher education is in line with the requirements of European standards, including independence of the Quality Assurance Agency.

Employment and labour markets

Kosovo's labour market performance in 2017 is marked by a noticeable rise in labour force participation translating into unemployment increase. From 2016 to 2017, the labour force participation rate increased by 4.2pps to 42.8%, the employment rate by 1.7pps to 29.7% and unemployment by 2.9pps to 30.4%. Trends show a marked gender difference. Male labour force participation (+7pps) and employment (+3.6pps) improved considerably, whereas the position of women on the labour market remains extremely weak with 12.7% employment (no change) and 36.5% unemployment (+4.8pps), thus widening further the gender gap. Youth unemployment remained at stubbornly high levels (52.6%, up 0.4pps), whereas the NEET share of the youth population (27.4%, -2.7pps) decreased for both men (23.6%, -2.9pps) and women (31.3%, -2.8pps).

Kosovo needs to focus more vigorously on enabling job creation in the private sector. Interventions in the established labour market framework and the further increase of incomes from transfers should be carefully considered as to their potential effects. The recently adopted modification of the minimum wage formula was followed by a proposal to increase the minimum wage from EUR 170 to EUR 250. An increase of this size would not be in line with the cumulative GDP and productivity growth over the past years, and may negatively affect the employment of young people and low skilled workers. Furthermore, such rise would create an additional burden on public finances through its direct implications on the expenditure for war veterans' pensions, as they would increase accordingly.

The reform measure aiming at increasing the access of young people and women to the labour market is too limited in scope to have a significant impact on employment. It is again rolled over from the previous ERP and consists mainly in capacity building of the new Employment Agency of Kosovo, which became a separate functional entity in 2017, for delivering services including active labour market measures to job seekers. Most of this measure's budget is reserved for the functioning of the agency, while the available budget for active labour market measures is too modest to have any significant impact. The planned activity of developing VET profiles, standards and curricula is not embedded in the other ongoing VET reforms. A more focussed policy approach to improve the marginal position of women in the labour market should be considered in the future planning of active labour market policies.

Responding to the policy guidance of 2016 and 2017, the first ever action plan for youth unemployment has been adopted. Its scope is still very limited compared to the high number of youth needing active support. Implementation according to schedule will be important, and the monitoring and evaluation of the impact of measures, in order to inform the design of further policies supporting youth.

Social inclusion, poverty reduction and equal opportunities

Due to the very low work intensity in Kosovo, poverty remains high and many people do not have access to essential services such as health. According to the latest poverty estimates from the Kosovo Agency of Statistics (KAS), in 2015 17.6% of the population lived below the poverty line (set at EUR 1.82 per day), with 5.2% living below the extreme poverty line (EUR 1.30 per day). Lower educated persons are more likely to be poor; the poverty rate of individuals who did not complete primary education is 22.9% compared to 6.2% for those who have competed tertiary education. Female-headed households have a significantly higher poverty rate (23.7%) compared to those headed by males (17%). Poverty is also more pronounced among children. Roma and Ashkali communities face disproportionately high levels of poverty and social exclusion given their low education and marginal employment levels.

Kosovo has still not started the implementation of the general health insurance scheme. The ERP rolls over the reform aiming at improving social and health services, with the ultimate objective of establishing a universal health insurance for the whole population. It represents a major challenge in fiscal terms since only a fraction of the population would contribute to the fund with own contributions as share of their salary. For other categories, the contribution would need to be covered by the general budget. The methodology of a poverty test for granting exemptions from paying premiums has been developed in 2017 and should be applied without further delay. The estimated revenues composition of the health insurance fund once operational (85% of premiums from contributions, 15% from general budget) risks underestimating the funding needs of such a system.

Social transfers and assistance are not sufficient to lift people out of poverty. In 2015, 77% of household social assistance recipients were poor, representing 13% of the poor population. Pension recipients face a poverty rate of 27.8%; their share among the poor population is 13.7%, whilst 8.7% of total population. The targeting of the social assistance scheme is accurate, but coverage and adequacy have been low. To improve the situation, the ERP measure includes the increase of social welfare benefits by 20% in 2018 and the introduction of support to specific categories. Further reform steps envisage the provision of social services at the local level.

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2017

2017 policy guidance	Summary assessment
PG 1: Enhance the institutional capacities and ensure appropriate staffing at the Ministry of Finance in order to improve macro-fiscal planning, forecasting and fiscal impact assessments. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultations with stakeholders, including the EU.	There has been **limited implementation** of PG 1: • **Limited implementation:** Several activities have been implemented to upgrade the skills and train the existing staff and to recruit new staff for the department. The process of employment of additional staff for the Macro department started (but not yet finalized) • **No implementation:** No options paper was prepared for an independent body of fiscal oversight.
PG 2: Strengthen institutional capacities at central and local government levels for public procurement, multiannual investment planning, and investment project preparation and management in order to improve the execution of capital spending. Take steps towards introducing targeting and means-testing to all war veteran programmes in order to further contain current expenditure.	There has been **limited implementation** of PG 2: • **Partial implementation:** Capacity building concerning the e-procurement platform was carried out in 2017 for contracting authorities. The Ministry of Finance worked (assistance by GIZ) on drafting an Administrative Instruction on defining and setting criteria for the selection of capital projects. The Administrative Instruction aims at defining principles, criteria, procedures and rules pertaining to the evaluation, prioritization and selection of capital projects. • **No implementation:** On the introduction of targeting and means-testing for all war veteran programmes no progress was made.
PG 3: Further address the underlying legal and institutional factors hampering access to finance for corporates to improve banks' incentives to lend to enhance financial intermediation in the economy. Continue improving the central bank's analytical toolkit (including through the establishment of a reliable measure of private sector inflation expectations in order to better gauge underlying price dynamics) and develop a liquidation and bank resolution framework to strengthen the overall resilience of the banking sector.	There has been **limited implementation** of PG 3: • **Partial implementation:** The Law on Enforcement procedures was amended, aiming at improving access to finance through reduced collateral requirements for borrowing and lower interest rates. The Kosovo Credit Guarantee Fund expanded its activity in 2017, and currently most banks are registered with the KCGF. • **No implementation:** • An inflation expectations survey has not been established. While the central bank is currently investigating practices applied by other countries and expects launching the first survey end-2018, no survey is yet in place. • **Limited implementation:** • The respective frameworks are currently being developed through technical assistance from the EBRD and the World Bank, but have not yet been finalised.**]**
PG 4:	PG 4 has been **partially implemented**:

Establish a financing mechanism to support energy efficiency measures and adopt energy efficiency incentives to the private sector and households. Complete the deregulation of energy generation prices, gradually deregulate electricity supply prices and gradually adjust energy tariffs to reflect actual costs.	• **Limited implementation:** The draft Law on Energy efficiency includes the establishment of an energy efficiency fund. It has been prepared and is expected to be adopted by June 2018. The EE Fund will not include energy efficiency incentives for private sector and households in a first phase. • **Full implementation:** Conventional generation prices were deregulated as of 1 April 2017. Electricity supply prices have been partially deregulated and the gradual adjustment of energy tariffs to reflect costs has started.
PG 5: Complete the risk assessments focusing on the sectors and branches most vulnerable to informalities and identify and apply appropriate corrective measures.	There has been **limited implementation** of PG 5: • **Partial implementation:** Risk assessments for 4 sectors (construction, gambling, agriculture and retail) have been completed • **No implementation:** No corrective measures adopted.
PG 6: Adopt an action plan for tackling youth unemployment, based on a sound assessment of the challenges. Finalise the operationalization of the Employment Agency. Target reforms in vocational education and training and higher education on business sectors with labour demand and job creation potential. Increase enrolment in pre-school education.	PG 6 has been **partially implemented**: • **Full implementation**: The Action Plan has been adopted. • **Substantial implementation**: The Director of the Employment Agency has been appointed; this was the condition for the EA to become a self-standing body. Recruitment process for managerial and technical staff for the central level of the EA ongoing in 2018. • **Limited implementation:** 20 new occupational standards drafted in 2017; • **Partial implementation**: Enrolment figures increased by around 5pps for 4-5 and 5-6 year olds, but no progress for children aged below 4.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The Economic Reform Programme 2018-2020 was adopted by the Government on 29 January 2018 and submitted to the Commission on 31st January 2018 within the deadline. It is in line with the previously approved medium-term fiscal strategy and national development strategy. No components of the ERP are missing.

Inter-ministerial coordination

The preparation of the ERP was centrally coordinated by the Ministry of Finance with the support of the Office for Strategic Planning in the Office of the Prime Minister (OPM). All relevant line ministries contributed to the drafting of the programme and were fully consulted.

Stakeholder consultation

Section 6 of the ERP provides information on the public consultation of the ERP. A draft ERP was made available to the public on the OPM website in December 2017 and was emailed to a number of external stakeholders. A meeting was also held to discuss the draft on 15 January, chaired by the Minister of Finance. . Written comments from stakeholders were annexed to the ERP.

Macroeconomic Framework

The presented macro-fiscal framework in the 2018 ERP is broadly plausible. External assumptions have been taken from the IMF October 2017 World Economic Outlook and the Commission's autumn 2017 forecast. Credibility of the fiscal framework has been largely maintained on the account of more conservative revenue projections. Both the low and the high growth alternative scenarios are useful to showcase the likely impact of some expected and unexpected developments in Kosovo's economy. Forecasts for the labour market and the financial sector are still missing. The cyclical analysis presented in the ERP has its limits given the short time series available.

Fiscal Framework

The fiscal framework was prepared based on the 2018 budget. It envisages broadly plausible revenue projections due to maintained growth. On the expenditure side the framework foresees a substantial fiscal expansion through higher investments. However, risks of capital under-spending and further ad-hoc increases of current spending remain. Unlike in previous years structural measures included in the ERP have all been budgeted in the 2018 budget.

Structural reforms

The structural reforms sections (4, 5 and 6) follow the guidance note. The reporting of the implementation of the policy guidance and the structural reform measures from the 2017-2019 ERP (table 12 in annex) is both sufficient and up-to-date. The number of reform measures is limited to 20 and the page limit (40) for section 4 is respected. The structure of the reform measures is good, in terms of scope and clarity of timeline and budget for activities planned in the three years of the programme. However, activities could be more precise. Tables 9-11 of the annex are filled in appropriately.