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From:	General Secretariat of the Council
To:	Delegations
Subject:	Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey

Delegations will find attached the text of the Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey.

JOINT CONCLUSIONS OF THE ECONOMIC AND FINANCIAL DIALOGUE BETWEEN THE EU AND THE WESTERN BALKANS AND TURKEY

The Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, Brussels, 12 July 2021

Representatives of the EU Member States, the Western Balkans and Turkey, the European Commission and the European Central Bank, as well as representatives of the central banks of the Western Balkans and Turkey[1] met for their annual economic policy dialogue[2]. The dialogue aims at preparing the Western Balkans and Turkey for their future participation in the European Semester.

The COVID-19 pandemic has confronted EU Member States, the Western Balkans and Turkey with similar unprecedented major public health, economic and social challenges. Participants acknowledged the strong solidarity between the EU and the Western Balkans and Turkey, demonstrated by providing medical and financial assistance to fight the COVID-19 pandemic and contributing to address its socio-economic impact in the region. Participants welcomed the overall timely fiscal and monetary support measures adopted by the Western Balkans and Turkey to mitigate the economic fall-out of the crisis. Participants considered it appropriate to continue mitigating the pandemic's impact on growth, employment and social cohesion by adequately targeted, temporary and transparent fiscal and financial measures until a self-sustained recovery is firmly established.

Looking beyond the protracted crisis impact, participants agreed that the economic policy dialogue should continue to play a central role for providing jointly agreed policy guidance to support medium-term economic recovery and sustainability and support the enlargement partners in meeting economic accession criteria in line with the revised EU Enlargement Methodology. In order to build up economic resilience in the longer term, measures should also foster the digital transformation and the green transition. Participants emphasised in particular that strong ownership will be key to a successful implementation of the jointly agreed policy guidance. Participants underlined their commitment to this economic and financial dialogue and encouraged the Western Balkans and Turkey to foster a strong recovery via further improvement of their macroeconomic, budgetary and structural policies in a medium-term perspective in view of their long-term development. Participants regretted that Montenegro's Economic Reform Programme had been submitted with a significant delay. The dialogue will continue in 2022, including on the implementation of these conclusions.

1 Montenegro, the Republic of Serbia, the Republic of North Macedonia, the Republic of Albania and the Republic of Turkey are candidate countries for EU accession.

2 The conclusions of this dialogue are without prejudice to EU Member States´ positions on the status of Kosovo.

Turkey

Turkey submitted its Economic Reform Programme 2021-2023 on 1 February 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented.

Turkey was one of the few countries in the world with a positive economic growth in 2020, but this outstanding performance came at the cost of exacerbating existing vulnerabilities and increasing inequalities as an adverse effect of the pandemic and the chosen policy mix. Growth was driven by a low base effect, strong growth momentum prior to the pandemic, and a sizeable policy stimulus that boosted domestic demand. In order to mitigate the adverse effects of the pandemic, various measures were taken, including tax reductions and deferrals, higher unemployment benefits and short-term work allowances. The crisis response was dominated by a large credit impulse, led by state-owned banks and supported by private banks, and underpinned by a rapid relaxation of monetary conditions that was later reversed in view of worsened inflation prospects and exchange rate depreciation. The ERP’s economic outlook is positive, with a strong rebound expected in 2021. Correcting existing vulnerabilities, however, will likely take longer and requires the sustained application of stability-oriented policies and advancing market-friendly structural reforms, outlined in the ERP and in the economic reform package recently announced by the government. Reducing the high level of dollarization poses a particular challenge. In view of the severely reduced buffers and challenges in the application of an appropriate policy mix, Turkey remains very exposed to changes in global financial markets and investors’ sentiment in a challenging geopolitical environment.

The fiscal policy response to the crisis involved a rather limited increase in direct crisis-related expenditure. Together with strong revenue performance, boosted by buoyant domestic demand and targeted tax increases, this resulted in a fiscal tightening in 2020. In continuation with the previous programme’s intentions, the authorities envisage a continued frontloaded fiscal consolidation. The magnitude of the planned consolidation in 2021, however, may be ambitious in view of significant uncertainty about the economic recovery in the aftermath of the pandemic and the challenging labour market situation. The programme’s medium-term deficit path assumes a continuous decline in the primary expenditure ratio, to a level not seen in a decade. In view of the high uncertainty, a strong asset of the programme is that it presents prudent revenue estimates. Government debt is projected to stabilise close to 40% of GDP, but its maturity and currency structure should be closely monitored. Transparency and public finance reforms have advanced. However, fiscal risks, in particular from quasi-fiscal activities, remain elevated.

The long-standing market concerns over too accommodative monetary policy, in particular in response to pandemic, were alleviated under the central bank management appointed in November 2020. They demonstrated a strong commitment to reduce inflation, which remains in double digits, by significantly tightening the monetary policy stance and simplifying the monetary policy framework, which gave a strong boost to market confidence. It also helped stabilise the exchange rate and contain further pressure on declining central bank reserves. However, the unexpected change of the central bank governor in March 2021 renewed market concerns about central bank independence and created uncertainty over future policies. The initial negative impact on market confidence, also reflecting volatility in global financial markets, erased most of the exchange rate gains after November 2020. The announcements of the new governor indicating continuity of the central bank's monetary policy strategy helped stabilise the exchange rate. In response to the pandemic the authorities have taken decisive measures to provide borrower relief and help smoothing the adjustment of the banking system to the shock. While this has helped improve liquidity conditions in the market and credit flows, it has deepened the uncertainty about the state of banks' asset quality. The banking sector remains well capitalised and liquid, but profitability declined, which is likely to come under further pressure given the possible deterioration in asset quality in the aftermath of the pandemic, once borrower and regulatory relief measures are phased out. Banks also remain exposed to indirect credit risks stemming from the still elevated share of foreign exchange denominated corporate debt. At the same time, foreign exchange denominated corporate debt has decreased since 2018.

The path of the post-pandemic recovery will significantly depend on the governments' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages. The recovery would also benefit from further efforts to improve the rule of law, enhance transparency and strengthen institutions and social dialogue. The implementation of the measures announced in the Human Rights Action Plan of March 2021, notably regarding the fight against corruption, will be highly important in this regard. As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) improving transparency and predictability in the regulatory and institutional environment affecting businesses, (ii) increasing employment, in particular of women and young people, and formalisation of employment and (iii) raising the performance level of the education system. Despite a firm rebound from the initial shock of the COVID-19 pandemic on the economy, a strong need for effective and well-coordinated structural reforms for sustaining the post-crisis economic recovery persists. The timely implementation of the reform agenda announced recently by the government against well-defined targets will be a critical factor in the government's policy response for shaping the economy in the post-crisis context and regaining the necessary business' and investors' confidence. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and will benefit from further easing of regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, and should be supported by continued efforts to reduce the large informal sector. The employment rate declined in 2020 in comparison to 2019. The share of young people not in employment, education or training has increased and despite the improvements in recent years, female participation rate is structurally low. The share of informal employment continues to be large. The further development of a knowledge-based economy requires improving the quality and coverage of education and training at all levels; this is also key for increasing labour market participation, in particular making better use of the labour market potential of women and youth. Social dialogue remains marginal, considering its potential for employment and social policy.

Participants take note that Turkey has improved compliance with respect to annual national accounts but data gaps still exist. Turkey has also made progress in short-term business statistics. Turkey should give priority to the transmission of excessive deficit procedure notifications, government finance statistics and further improve annual and quarterly national accounts.

In light of this assessment, Participants hereby invite Turkey to:

1. Maintain the fiscal policy stance consistent with the aim of supporting disinflation and lowering vulnerabilities, while increasing support to the most vulnerable households and providing adequate allocations for capital expenditure and active labour market policies. Adopt a 2022 budget together with a plan for a gradual fiscal consolidation over the medium term. Increase the share of local currency in new borrowing.
2. Expand the tax base by developing a plan to streamline gradually tax exemptions and reductions. Reduce expenditure arrears and improve their monitoring and control. Adopt the new framework legislation on Public Private Partnerships in order to improve their management and monitoring.
3. Maintain a sufficiently tight monetary policy stance, at the central bank's own discretion in line with instrument independence, as well as a transparent operational framework needed to reduce inflation and bolster market confidence. Maintain a strong financial sector regulatory framework in line with international and EU best practices, ensure sound credit risk management, a transparent display of asset quality and adequate provisioning. Continue to improve legal, institutional and regulatory frameworks to foster swift and efficient NPL resolution, including the further development of the NPL market.
4. With the aim to improving the business environment, further strengthen the rule of law and the regulatory environment and improve consultation mechanisms with business organisations and social partners on relevant new legislation. Implement legislation and enhance transparency regarding state aid. Finalise the legislation on easing private investments and prepare its implementation.
5. Increase the provision of active labour market policy measures for young people. Incentivise further female labour participation through legislative and fiscal measures and provision of appropriate and affordable childcare infrastructure beyond the big urban centres of Turkey. Intensify and diversify policy tools in order to increase the transition to formal employment in the labour market in the aftermath of the pandemic, including for the migrant workers and the workers under temporary protection.
6. Continue to roll out mandatory pre-school education and advance further towards a 100% enrolment in primary and secondary education with updated curricula. Address high youth unemployment and NEET rates through better access to education and improved VET, as well as outreach to young NEET. Increase offers and participation in lifelong learning measures and step up re- and upskilling possibilities for the labour force.

Montenegro

Montenegro submitted a partial draft of its Economic Reform Programme (ERP) 2021-2023 on 15 February, followed by additional updates in March. The ERP was formally adopted by the government on 1 April 2021. The absence of a timely and comprehensive programme, with detailed information on the 2021 budget and the medium-term fiscal strategy, did not allow for a detailed assessment of the programme. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented.

The restrictions imposed in the context of COVID-19 took a heavy toll on the tourism-dependent economy. Due to the pronounced deterioration of external and domestic demand, real GDP contracted by 15.2% in 2020. The draft ERP's baseline scenario expects the economy to partially rebound in 2021, supported by an assumed improvement of the health situation in the second half of the year, and to reach its pre-crisis level already in 2022. The completion of the first section of the Bar-Boljare highway together with an expected recovery of tourism would lead to a narrowing of the current account deficit, turning net exports into a key driver of growth. However, as elsewhere, risks are to the downside, and delays with the start of the COVID-19 vaccination could challenge this recovery scenario.

The impact of the pandemic widened the budget deficit, which climbed to 11% of GDP in 2020, while public debt rose to more than 100% of GDP. Going forward, the programme foresees a sizeable improvement of the budget balance, to reach a surplus in 2023. Along with the use of accumulated large government deposits to reimburse maturing debt, this would lower the public debt ratio by up to 34 pps in 2021-23, albeit in a very favourable scenario. However, this favourable scenario is surrounded by a high degree of uncertainty. The programme does not present new consolidation measures and seems to rely on the rebound of the economy to improve tax revenue, along with the phasing out of highway-related capital spending and the withdrawal of crisis-related fiscal support. Regular current spending would be contained, among others, by optimising the number of public administration jobs. Overall, non-discretionary spending and the high public debt burden represent significant challenges calling –once the economic recovery takes hold– for a credible consolidation path, including a containment of current spending and further broadening of the tax base. Moreover, given the prevalence of ad hoc decisions and a track record of fiscal slippages, there is a need to keep strengthening fiscal frameworks and governance.

The central bank lowered reserve requirements to release liquidity to the banking sector, the only monetary tool available under Montenegro's monetary framework. The banking sector has shown resilience so far, but the full impact of the crisis is yet to become visible. The authorities have granted loan moratoria and relaxed prudential measures to support the economy and ease the adjustment of the banking system to the severe economic shock. The overall indicators on capital adequacy and liquidity remain sound thanks to banks' robust pre-crisis position and the authorities' crisis support measures, while profitability declined. While support measures should help to avoid bankruptcies of viable clients, the pandemic is expected to lead to rising NPLs after support measures expire. The ongoing Asset Quality Review will help identify and address specific banks' weaknesses and contribute to increasing the trust in the banking system. There has been only limited progress in strengthening the broad legal, judicial and regulatory framework to expedite NPL resolution. Progress will require joint efforts by all stakeholders.

The path of the post-pandemic recovery will significantly depend on the governments' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages, including the Economic and Investment Plan for the Western Balkans. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue. As regards structural reforms, the main challenges in terms of boosting competitiveness and long-term, and inclusive growth are (i) strengthening the regulatory environment, (ii) formalisation of the economy and (iii) increasing employment, in particular of women and young people, and tackling long-term unemployment. Making the regulatory environment friendly for businesses calls for continuous commitment from the state and local authorities. Administrative delays, discretionary behaviour and inconsistencies in interpreting and implementing law are among the main issues to be addressed. Mechanisms for continuous dialogue with businesses and social partners require development, as demonstrated during the COVID-19 crisis. E-procurement rollout and simplification of taxation should be prioritised. Large informal sector continues to hinder economic and social development. The existing measures and approach to informality would require re-evaluation and significant adjustments. Preventive and educational actions, as well as incentives for the formalisation of businesses and labour are needed along controlling and suppressing actions. Ensuring full cooperation between central and local-level authorities would be paramount for all three key challenges. The persistently low activity and high unemployment rates, especially among women, young people and the low-skilled and high long-term unemployment have been further exacerbated by the COVID-19 crisis. The rate of young people not in employment, education or training remains high. Skills mismatches remain an obstacle to transitioning into employment. The improvement of the effectiveness of active labour market measures and coordination between employment and social services recorded limited progress and therefore disincentives to work persist. Further progress on strengthening social dialogue is needed.

Participants take note that Montenegro made progress in several statistical areas, namely in national accounts (by providing output annual data in chain-linked volume), energy statistics and short-term business statistics. However, serious gaps remain in national accounts and the harmonised indices of consumer prices need further attention. Montenegro should also give priority to the transmission of excessive deficit procedure notifications and government finance statistics.

In light of this assessment, Participants hereby invite Montenegro to:

1. Provide well-targeted and temporary pandemic-related fiscal support to vulnerable households and businesses; provided that the economic recovery takes hold by the time of adoption of the 2022 budget, supplement the budget with a medium-term fiscal consolidation plan foreseeing a gradual reduction of the budget deficit and public debt ratio, starting in 2022. Prepare a new public administration optimisation plan with a view to contain the share of the public sector wage bill in GDP. Establish an IT system for electronic management and security printing of excise stamps in order to broaden the tax base by reinforcing the fight against informality and tax avoidance. Advance the implementation of a public investment management assessment (PIMA) programme, to improve the quality of public investments.

2. Adopt amendments to the Law on Budget and Fiscal Responsibility with the aim of setting up an independent body in charge of fiscal oversight. Develop a comprehensive overview of all tax exemptions, including an analysis of their economic and social impact. Support the economy and business liquidity by reducing public sector arrears and deadlines for VAT return.

3. Maintain a strong financial sector regulatory framework in line with international and EU best practices, ensure sound credit risk management, a transparent display of asset quality and adequate provisioning. Further reduce institutional and legal obstacles to swift and effective NPL resolution mainly outside the responsibility of the central bank, including by facilitating out-of-court settlement and modernising the insolvency regime. Complete the ongoing Asset Quality Review, transparently publish its general findings and timely take remedial action where needed.

4. In cooperation with local authorities and representatives of business community, conduct an analysis of businesses-related procedures at the local administration level to identify sources of possible inefficiencies and propose improvements of the institutional and regulatory environment, including for infrastructure developments. Establish technical-level mechanisms and administrative best practices allowing for a continuous structural dialogue between authorities and the business community. Focus on further simplifying business taxation, reducing number and diversity of para-fiscal charges and facilitating payment of tax commitments.

5. Prioritise digitalisation of the public sector and development of transactional electronic government services to speed up and enhance the economic recovery. Finalise work on a new action plan to tackle informality and start implementing it, including targeted preventive measures and incentives to legalise informal businesses and employees. Ensure structural cooperation between central and local authorities in the development and implementation of measures aimed to reduce the informal economy.

6. Establish an inter-ministerial task force involving relevant ministries, their agencies and stakeholders to develop a Youth Guarantee Implementation Plan. Based on the review of the social protection system, finalize the roadmap and start implementing social protection reforms. Prepare, in cooperation with the business sector, a roadmap with concrete measures for reforming the practical and dual VET education system to improve their impact on labour market outcomes.

The Republic of Serbia

Serbia submitted its Economic Reform Programme 2021-2023 on 29 January 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented.

The Serbian economy recorded only a mild contraction in 2020 resulting from decreases in private consumption, net exports and private investment that were partially offset by higher government consumption and investment and higher inventories. The impact of the COVID-19 crisis was mitigated by a strong pre-crisis momentum, sizeable and timely fiscal and monetary support measures, the sectoral structure of the economy and a relatively low average stringency of containment measures. In addition, contraction of goods exports was limited due to expansion of export capacity after strong manufacturing FDI and geographic diversification achieved in earlier years. The ERP projects the economy to rebound strongly in 2021 and to expand at pre-crisis growth rates thereafter, driven by private consumption, investment and exports. While net exports are expected to subtract from growth in 2021 as domestic demand rebounds, the ERP expects their contribution to GDP growth to be close to balance as of 2022 as export growth is expected to substantially exceed import growth.

As a result of the economic crisis and very sizeable fiscal mitigation measures, the general government deficit increased substantially, to around 8% of GDP in 2020. While the original 2021 budget targeted a strong reduction of the deficit to 3% of GDP, mostly reflecting non-renewal of the crisis-mitigation measures, the April 2021 amending budget projects the deficit to reach 6.9% of GDP mostly due to renewed and additional support measures and increased capital spending. The ERP projects further gradual fiscal consolidation towards a budget close to balance in 2022 and 2023. The debt-to-GDP ratio, after rising by five percentage points to around 58% of GDP in 2020, is projected to gradually decline as of 2021 in the ERP baseline. However, the additional fiscal support in 2021 is set to delay fiscal consolidation and the declining trend of the debt-to-GDP ratio by one year. To reinforce the medium-term sustainability of public finances, remaining gaps in fiscal governance need to be addressed, in particular as regards fiscal rules and the containment of the public sector wage bill. Increased transparency on fiscal risks related to state-owned enterprises (SOEs), improvements in SOE governance and reforms to support revenue fiscalisation and electronic invoicing would also contribute to further enhance medium-term policy credibility and reduce the informal economy.

In a timely and forceful response to the pandemic, the National Bank of Serbia (NBS) has taken a range of measures to maintain price stability and support the economy. The NBS cut the key policy rate by a cumulative 125 basis points, narrowed the interest rate corridor, provided additional liquidity to the financial sector and engaged in purchases of government and corporate bonds on the secondary market. The NBS also intervened substantially in the foreign exchange market to maintain a stable exchange rate. Headline inflation fluctuated around the lower bound of the tolerance band over 2020. The banking sector remained resilient, with high capitalisation and adequate liquidity. To ease pressures related to the pandemic and support credit growth, inter alia loan moratoria for corporates and households and a government guarantee scheme for new loans were introduced. The possible rise of NPLs once economic support and relief measures are phased out points to the importance of an effective NPL resolution framework, based on considerable progress made to this end already. Currency substitution, notwithstanding progress in dinarisation, continues to pose a tail risk to financial stability through indirect credit risk.

The path of the post-pandemic recovery will significantly depend on the governments' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages, including the Economic and Investment Plan for the Western Balkans. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue. As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are linked to (i) further improving the business environment for investment, (ii) greening the country's energy sector and fully opening the energy market, and (iii) continued employment increases, in particular of young people and women, and improving social protection against poverty. Business predictability should be further improved by ensuring full transparency in the adoption of legislation. A certain share of public funds for capital investment continues to be spent without sufficient transparency and proper checks to ensure compliance with public procurement, state aid and technical standards, particularly when it comes to big infrastructure projects financed by third-country loans. The implementation of the legal framework in the fields of competition and state aid remains to be strengthened. Serbia remains highly dependent on coal and needs to develop a coherent long-term strategy that combines energy and climate targets. Major investments are needed to modernise energy infrastructure and lower carbon emissions. Implementation of the primary legislation in the energy sector should be strengthened, particularly in the gas sector. The public expenditure on social protection in Serbia has been gradually decreasing in recent years and the benefits for the part of the population most in need are not commensurate to the cost of living. The tax wedge of low wage earners remains too high to bring people out of in-work-poverty. VET education is not well oriented to labour market needs with low exposure of students to the workplace. School-to-work transitions remain structurally difficult leading to a high amount of young people not in employment, education or training. Social dialogue, in particular in the private sector, needs to be developed further.

Participants welcome that Serbia has increased its efforts in the area of national accounts. Serbia transmits the entire set of monthly MFI Interest Rate Statistics and has had a good level of compliance with regard to short-term business statistics, harmonised index of consumer prices and balance of payments. Further progress is expected regarding adherence to excessive deficit procedure methodology and government finance statistics. The missing data series in the area of national accounts should also be addressed.

In light of this assessment, Participants hereby invite Serbia to:

1. Provide well-targeted and temporary pandemic-related fiscal support to vulnerable households and businesses; provided the economic recovery is well entrenched, plan a gradual return to a deficit close to balance in the 2022 budget and medium-term fiscal framework. Contain overall spending on wages as a percentage of GDP by adopting an adequate wage indexation mechanism and taking steps towards an appropriately designed public sector wage system reform. Adopt a credible and binding system of fiscal rules for entry into force as of 2022.

2. To reduce the grey economy, increase VAT collection and improve the tax control process, implement the new model of electronic fiscalisation and the transition to electronic invoicing according to the ERP 2021 timeline. To increase the transparency of the fiscal impact of state-owned enterprises, reinforce fiscal risk analysis capacity and publish quarterly reports on SOEs' financial performance.

   Implement the first steps of the time-bound action plan for deployment of the new SOE ownership and management strategy to improve the governance of SOEs and reduce related fiscal risks.

3. Maintain a strong financial sector regulatory framework in line with international and EU best practices, maintain sound credit risk management, as well as a transparent display of asset quality and adequate provisioning. Further reduce remaining obstacles to swift and effective NPL resolution. Continue efforts to promote the use of the national currency, including by further encouraging forex hedging and raising awareness of risks related to forex lending.
4. Further improve transparency in the adoption and implementation of legislation, particularly by ensuring a timely consultation of businesses and social partners on new legislation affecting their operations. Ensure a harmonised approach for prioritising and monitoring all investments and base investment decisions on feasibility studies, cost-benefit analysis and environmental impact assessments. Apply the principles of competition, equal treatment, non-discrimination and transparency in public procurement and state aid procedures in line with the EU *acquis* for all public investment projects regardless of the financing source and ensure an operational independence of the Commission for State Aid Control.
5. Develop a long-term energy and climate strategy in line with the Green Agenda for the Western Balkans and international commitments, and step up investments in modernising energy infrastructure and lowering carbon emissions. Implement regulatory, financial and institutional measures for higher take-up of renewables and energy efficiency, including introducing renewable energy sources (RES) auction system and establishing a sustainable financing mechanism for energy efficiency. With a view to further liberalising the energy market, address outstanding reforms, in particular of the energy utility EPS, including price and tariff reform, accelerate the unbundling of Srbijagas in a manner compliant with the EU acquis, and provide third-party access to gas infrastructure.
6. Reduce poverty by increasing the adequacy of benefits of the Financial Social Assistance (FSA) scheme for individuals and families with children and by increasing substantially the untaxable wage base close or equal to the level of the minimum salary for workers. Facilitate school-to-work transitions by stepping up further VET, including dual VET, through revised curricula and the provision of infrastructure which enables the acquisition of practical skills. Develop in co-operation with all relevant ministries, their agencies and stakeholders a Youth Guarantee Implementation Plan.

The Republic of North Macedonia

North Macedonia submitted its Economic Reform Programme 2021-2023 on 29 January 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented.

North Macedonia's economy was on a clear path of accelerating growth in the two years prior to the crisis. When the pandemic hit the country in March 2020, and wide-ranging containment measures became necessary, domestic economic activity plunged, and external trade suffered from lockdowns and recessions in trading partner economies. Private transfers from abroad declined markedly. Overall, real GDP dropped by 4.5% in 2020. In response to the crisis, the government successively adopted four sets of anti-crisis measures in 2020 to support households and businesses. These include subsidies to wages and social contributions, tax deferrals, interest-free loans, payment cards etc. Government fiscal support programs substantially alleviated the crisis impact on workers and firms, thereby successfully limiting a more severe recession in 2020.

The ERP expects a gradual strengthening of the economic recovery, driven by domestic demand, with output to reach its pre-crisis level by 2022. On average, real GDP would rise by 4.6% per year between 2021 and 2023, which appears to be a very optimistic outlook. Household spending would be supported by a rebound in remittances from abroad, and public investment is projected to rise significantly.

As a result of contracting economic activity and the discretionary fiscal support, the budget deficit rose to 8.2% of GDP, and general government debt increased by 10.5pps, to 51.2% of GDP in 2020. The authorities plan to gradually resume their path of fiscal consolidation, with the primary deficit reaching its pre-crisis level by 2025. The ERP projects a further rise in the debt ratio until 2023, and stabilisation thereafter.

In light of lingering uncertainty about the course of the pandemic and its impact on the economy, the government should continue to provide support to households and companies through well-targeted, transparent and efficient fiscal measures. Once the recovery is firmly under way, fiscal policy should refocus on building fiscal buffers and reducing debt. This should be supported by improved revenue collection and through reducing tax expenditure. Importantly, more fiscal space would facilitate better implementation of growth-enhancing capital expenditure, which, in turn, would benefit from improved management of public investment. A wider use of well-managed public-private partnerships could also support better implementation of public investment. Improved fiscal governance through the swift introduction of fiscal rules and the establishment of a fiscal council would underpin the consolidation of public finances.

The monetary accommodation provided against the background of the crisis by the National Bank of the Republic of North Macedonia (NBRNM) has been appropriate. It is crucial to safeguard the NBRNM's independence, which is key in preserving price and financial stability. The banking sector has been resilient to date maintaining sound indicators, supported by the central bank's financial sector policies, while it will take time for the full impact of the crisis to become visible. The overall indicators on capital adequacy, liquidity and profitability remained sound thanks to banks' robust pre-crisis position and the NBRNM's supportive monetary and financial sector measures. While support measures can prevent the bankruptcies of viable clients, the fallout of the recession is expected to increase default rates and non-performing loans (NPLs). Therefore, it remains important to strengthen the broad legal, judicial and regulatory framework to expedite NPL resolution. Progress would require joint efforts by all stakeholders. The new insolvency law that modernises insolvency regimes and expedites the resolution of NPLs is yet to be adopted.

The path of the post-pandemic recovery will significantly depend on the governments' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages, including the Economic and Investment Plan for the Western Balkans. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) increasing the competitiveness of domestic companies and their integration into global value chains, (ii) formalisation of the informal economy, and (iii) improving the quality and relevance of the education system to increase employment and mitigate skills mismatches. The COVID-19 pandemic has put further significant burdens on companies, causing them to lower their investment in development of human and physical capital. At the same time, the crisis has revealed vulnerabilities in global value chains that also affected local companies. In this context, raising competitiveness will require improvements to human and physical capital and to the business environment, including better enforcement of business regulations and corporate governance, as well as better services including trade and transport logistics. More investment in research and innovation, as well as further regional integration could support the overall competitiveness. The COVID-19 crisis has also highlighted the importance of tackling the informal economy, as it creates challenges in the business environment, harms public revenue collection, and reduces formal employment and its associated benefits, including job security and safety at work. Insufficient quality of education contributes to persistent unemployment and a high share of young people not in employment, education or training. Youth Guarantee has been implemented countrywide to partly address the situation, yet the reform of education is a primary concern to improve employability. As a result of a comprehensive analysis of the education funding system, a new formula promoting transparency and efficiency in the resource allocation mechanisms for the financing of the VET and higher education shall be developed to increase their financial sustainability and achieve their further improvement. Improving the cooperation between the Employment agencies and social work centres is imperative in order to provide better services to the population in the field of social protection and to maximize the efficiency of the resources. Bipartite social dialogue in the private sector remains weak and the tripartite consultations need to be stepped up.

Participants welcome that North Macedonia made progress concerning annual and quarterly national accounts, excessive deficit procedure notifications, foreign direct investment and short-term business statistics. Further progress is expected regarding adherence to excessive deficit procedure methodology. North Macedonia has yet to provide quarterly government finance statistics.

In light of this assessment, Participants hereby invite the Republic of North Macedonia to:

1. Provide well-targeted and temporary pandemic-related fiscal support to vulnerable households and businesses; provided the economic recovery is well entrenched, foresee in the 2022 budget and the medium-term fiscal plan a gradual return to the pre-crisis primary deficit to GDP ratio. Also with a view to improving the realisation of capital expenditure, reinforce the management of public investment, in line with measures outlined in the related Action Plan. Improve revenue collection and broaden the tax base in line with the Tax System Reform Strategy, including by drafting annual action plans to streamline tax exemptions.

2. Adopt the new PPP law and ensure its efficient implementation, including the development and functioning of the PPP registry. Take the necessary legislative steps for the establishment of the Fiscal Council. Improve transparency and evaluation of firm-level subsidies by setting up a state aid registry.
3. Maintain a strong financial sector regulatory framework in line with international and EU best practices, ensure sound credit risk management, a transparent display of asset quality and adequate provisioning. Further reduce institutional and legal obstacles to swift and effective NPL resolution, including by facilitating out-of-court settlement and modernising the insolvency regime. Safeguard the NBRNM's independence in its key statutory tasks, including in staffing issues, in line with the law on the national bank, and to this end exclude the NBRNM from the scope of the new law on administrative servants.
4. Improve transparency in the adoption and implementation of legislation, particularly by ensuring a timely formal consultation of businesses and social partners on new legislation affecting their operations. Use the list of mapped para-fiscal charges to clarify the public services provided through the proceeds of individual charges and identify those that need to be eliminated, remodelled or streamlined. Continue the digitalisation of public services for businesses and citizens.
5. Ensure high-level political commitment by all institutions relevant for the coordination and implementation of the Strategy and the Action Plan for formalisation of the informal economy. Assess the implementation of the 2018-2020 Action Plan and identify gaps, in particular related to tax policy and administration. Develop and implement the new 2021-2022 Action Plan.
6. Develop a new formula for the financing of the VET system and of higher education with a focus on the functioning of the Regional VET Centres. Strengthen access to active labour market policies, particularly for low-skilled unemployed and people in vulnerable situations. Increase the capacity of and cooperation between the employment agencies and centres for social work to provide integrated services and measures for improvement of inclusion in the labour market.

The Republic of Albania

Albania submitted its Economic Reform Programme 2021-2023 on 2 February 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented.

Albania was hit by the double shock from the earthquake of November 2019 and the COVID-19 pandemic. Domestic and international restrictions caused large losses in tourism and manufacturing, as well as a fall in private consumption and investment. Within the limited fiscal policy space, the government took swift and appropriate actions to support business, households and the health sector, which cushioned the impact on the labour market. Economic conditions started to improve in the second half of 2020 and GDP has decreased by 3.3%, less than the 4.4% expected in the ERP. The ERP expects an exceptionally high level of public investment to complete post-earthquake reconstruction to stimulate economic growth in 2021, while the recovery of private consumption, private investment and tourism is projected to accelerate as from 2022. The programme expects an average output growth of 5% in 2021-23 and a gradual decline of the unemployment rate to 9.4%.

The sharp drop in tax revenues in addition to unforeseen expenditure needs and post-earthquake reconstruction drove the fiscal deficit to 6.9% of GDP, while public debt increased less than expected to 76.1% of GDP in 2020, instead of 77.9% of GDP. The ambitious public investment plans are expected to keep the budget deficit above 6% of GDP in 2021, but the subsequent withdrawal of fiscal stimulus is expected to move the primary balance into positive territory by 2023, and to support the gradual reduction of the public debt ratio by some 4.3 pps over the ERP horizon. The commitment to fiscal consolidation needs to be supported by increased growth-friendly revenue mobilisation and an improved management of fiscal risks. Accelerated reforms of public financial management to improve expenditure efficiency and public investment management would enhance the quality of the fiscal stimulus. The public expenditure composition could be more growth-friendly if infrastructure investment is accompanied by increasing investment into human capital, which is a crucial factor for future growth and for which allocations remain low.

Monetary policy was appropriately eased further in response to the pandemic-induced economic downturn and below-target inflation, and unlimited liquidity to the banking system was provided. Monetary accommodation was complemented by measures on loan classification and borrower relief, which helped improve the cash-flow in the economy and sustain bank lending. These measures increased the uncertainty about the banks' asset quality. The NPL ratio remained the highest in the region and is likely to increase again once regulatory measures are phased out and the crisis impact on the repayment capacity of corporates and households becomes fully visible. The banking sector remains stable and well capitalised, but its profitability eroded considerably and could come under further pressure given the possible increase in NPLs. There has been only limited progress on removing remaining obstacles to NPL resolution, e.g. on resolving the legal deadlock around the private bailiffs or further strengthening the credit scoring system. With currency substitution still at high levels indirect credit risk also continues to pose a tail risk to financial stability.

The path of the post-pandemic recovery will significantly depend on the governments' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages, including the Economic and Investment Plan for the Western Balkans. The recovery would also benefit from further efforts to tackle corruption and money laundering, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) improving the business environment and investment climate by increasing government support and tackling informality; (ii) increasing innovation and skills of young people and adults to enhance employment; and (iii) increasing coverage and adequacy of social protection and health insurance to reduce the share of population at risk of poverty. The COVID-19 crisis highlighted the importance of extending measures to tackle the informal economy, as it has a negative impact on the business environment and harms public revenue collection, which is particularly relevant for the post-pandemic recovery. Increased funding in innovation, and in the links between business and academia could further nurture competitiveness. The share of young people not in employment, nor in education or training is high, despite an increasing educational attainment. Albania lacks tools for regular monitoring and forecasting of skills needs in the labour market thus hindering an adequate prioritisation of education offer, adult training and career guidance. The adequacy of allowances under the Economic Aid scheme is too low to combat the widespread poverty and social exclusion. Social services are scarce to enable active inclusion of vulnerable people and funds to establish new ones are stagnating, while the capacities of local governments to plan, establish and manage new services remain weak. The government took steps to increase health coverage for the large amount of uninsured citizens, but access to health continues to be limited mainly due to high out-of-pocket payments. Social dialogue remains very weak in both the public and private sectors.

Participants welcome that Albania made progress concerning annual national accounts, excessive deficit procedure notifications, annual government finance statistics, harmonised indices of consumer prices, balance of payments, energy statistics, and short-term business statistics. However, significant progress is needed in the domains of the excessive deficit procedure and national accounts, including quarterly national accounts and government finance statistics. Research and development, and labour market statistics also need attention.

In light of this assessment, Participants hereby invite Albania to:

1. Conditional on the economic recovery becoming well entrenched, foresee in the 2022 budget and medium-term fiscal plan a gradual reduction of the public debt ratio and, based on a realistic revenue forecast, a return to a positive primary balance as of 2023 in compliance with the corresponding fiscal rule. Complete the Medium-Term Revenue Strategy and begin its implementation in line with the inter-ministerial committee agreement but at the latest before the next ERP submission. Increase the institutional capacities of the fiscal risk unit to continue and expand its work without reliance on external assistance.

2. Continue to reduce the stock of contract-based arrears; reduce VAT arrears to zero in 2022 and analyse the reasons for the increasing arrears of local governments. Assess and approve all investments, which involve public funds including PPPs, through the same approval process and continue to report actual earthquake reconstruction expenditure in the consolidated budget implementation. Re-orient public expenditure composition towards development of human capital and innovation by foreseeing a continuous gradual increase of expenditure on education, health, social security and R&D in terms of shares in total expenditure.

3. Maintain a strong financial sector regulatory framework in line with international and EU best practices, ensure sound credit risk management, a transparent display of asset quality and adequate provisioning. Further reduce remaining institutional and legal obstacles to swift and effective NPL resolution, including by resolving the bailiff deadlock and strengthening bankruptcy proceedings. Continue with the implementation of measures aimed at promoting the use of the national currency, including by developing the market for forex hedging instruments.

4. Provide enhanced business support services to improve access to finance and entrepreneurial know-how. Improve transparency in the adoption and implementation of legislation particularly by ensuring an effective timely consultation of businesses and social partners on the new legislation affecting their operations. Draft and consult a comprehensive strategy to tackle and monitor all aspects of informality, with an action plan with baselines, including clear and measurable targets and establish the regular a performance-based monitoring of its implementation and results.
5. Establish an inter-ministerial task force involving relevant ministries, their agencies and stakeholders to develop a Youth Guarantee Implementation Plan. Develop institutionalised tools to monitor skills needs in the labour market with an aim to provide relevant career guidance and to improve the offer of short-term vocational courses accordingly. Incentivise the link between innovative businesses and academia in the upcoming draft Strategy on Business and Investment Development 2021-2027 by including clear targets to increase science and research funding and by creating the conditions for the development of business incubators.
6. Perform an assessment of the adequacy of benefits under the 'Economic Aid' scheme, taking into account the data from the 'Statistics of Income and Living Conditions' survey, in view of their systemic adjustment. Build capacities in local governments to apply for support from the Social Fund and to plan, manage and deliver social care services. Redesign coverage policy, including for outpatient medicine, to reduce unmet need for medical care and financial hardship, particularly among persons with disabilities and chronic disease, poor households, people aged 65 and over, and minorities.

Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2021-2023 on 5 February 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented.

The outbreak of the global health crisis and the related containment measures have sharply exacerbated an already ongoing slowdown, leading to an output contraction of some 4½% in 2020. Private consumption, investment and exports, in particular exports of services, such as tourism, dropped markedly. Furthermore, remittances declined substantially, with an important negative effect on disposable income. The impact on the labour market was cushioned by governmental measures to support employment. External balances deteriorated only slightly, as lower export revenues and reduced inflows of remittances and FDI were partly compensated by lower imports, as containment measures but also lower disposable income led to lower private consumption and investment. For 2021 and the following years, the programme expects a quite moderate recovery, with GDP growth accelerating from 2.5% in 2021 to 3.4% in 2023. The main drivers of growth are expected to be private consumption and investment, based on the assumption of accelerated structural reforms, which appears challenging given the country's track record.

In response to the crisis, the authorities planned additional spending of about 2½% of GDP for health related measures, for support to troubled companies and subsidised wages and social security contributions. Furthermore, another ½% of GDP has been reserved for providing pandemic-related loan guarantees. As a result, the general government balance is estimated to have deteriorated sharply in 2020, from a surplus of 2.2% of GDP in 2019 to a deficit of about 4% of GDP. The programme expects the deficit to drop to 0.6% of GDP by 2023, largely due to large cuts in spending, in particular on investment, while the revenue ratio is projected to decrease further. Public debt rose by around 4 pps. in 2020 and is set to increase further, to 37% of GDP at the end of 2021. In the following two years, low deficits and strengthening growth are set to lower the debt ratio to 35% of GDP. However, integrating into general government accounts off-budget liabilities, such as balance sheets of public enterprises, could lead to a substantial increase in the debt ratio. Once the COVID-19 related economic shock dissipates, increased efforts should be undertaken to avoid the increase in non-performing loans and company bankruptcies, to improve the quality of public finances by shifting public spending and revenue collection towards a more growth-supporting pattern, by improving the targeting of social spending as well as the efficiency and fairness of taxation. Moreover, country-wide medium-term coordination capacities as well and the quality of statistical data should be significantly improved.

Monetary policy has continued to be anchored around the currency board arrangement, which enjoys a high level of credibility with the general public and is a key ingredient of monetary stability to be based on central bank independence. Despite the challenges associated with the economic fallout from the pandemic, the central bank continued to secure the full convertibility of the domestic currency in 2020. The banking system weathered the crisis well to date. The banking supervision agencies coordinated their response to support the financial sector through a range of measures. Overall, the banking sector appears to have robust capital buffers and liquidity remains high. Bank profitability decreased, albeit from high levels and, in aggregate, remains positive. The quality of loan portfolios remained solid so far and while the support measures in place can prevent the bankruptcies of viable clients, NPLs are expected to rise once support measures are phased out and the impact of the crisis becomes fully visible. There was only limited progress regarding removing remaining obstacles to an effective and swift NPL resolution, such as enhancing the possibility to negotiate out-of-court restructurings or securitise and sell NPLs. The authorities made progress on the bankruptcy framework as the Law on Deposit Insurance was adopted. However, the Deposit Insurance Agency should further increase the coverage of insured deposits and increase its funding.

The path of the post-pandemic recovery will significantly depend on the governments' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages, including the Economic and Investment Plan for the Western Balkans. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, including by a swift introduction of a system of verification of asset declarations of judges and prosecutors and members of the High Judicial and Prosecutorial Council in line with European standards, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) improving the business environment through closer cooperation and coordination at all levels of government, (ii) making the public sector more efficient, in particular improving the performance, transparency and accountability of state-owned enterprises (SOE), and (iii) increasing employment, particularly of young people, women and people in vulnerable situations. Efforts towards coherent country-wide solutions to support the business environment and to strengthen the common internal market within the country are lagging behind. Policy coordination at all levels is required to implement much needed structural reforms to enhance economic performance. The COVID-19 pandemic has further increased the importance and urgency of overcoming the political stalemate and of addressing structural weaknesses. Some progress was made towards online business registration, also in view of reducing the significant informal economy. However, further progress is needed, also to support the post-pandemic recovery. In line with the Digital Agenda for the Western Balkans and the Economic and Investment Plan which aims to spur the long-term recovery, this includes fostering digital solutions contributing to a sustainable economy, better public services to businesses and citizens and implementation of customs legislation providing for simplified customs procedures. Further efforts are also required for enhancing public finance management, as well as significantly stepping up SOE sector reform, starting with enhancing oversight and transparency. A large share of the population is inactive and access to the labour market is challenging for young people, women and people in vulnerable situations. However, as labour market policy falls within the competence of the entities, it is difficult for the administration to come up with a solid and coherent countrywide diagnostic and to agree and implement the necessary reforms. High youth unemployment, even among university graduates, and the high share of young people not in employment, education or training point to a lack of alignment between education and training and labour market needs. The education system requires deep reform to address skills mismatch. Consultations with the social partners on the design and implementation of economic, employment and social policies are weak.

Participants welcome that Bosnia and Herzegovina made important progress by the submission of an excessive deficit procedure notification and transmission of quarterly balance of payments and international investment position and some progress on national accounts time series. Bosnia and Herzegovina has also put in place adequate infrastructure for data transmissions to Eurostat and the ECB. Progress in other statistical areas such as regional accounts, labour market statistics and harmonised indices of consumer prices was, however, limited. While efforts should be pursued to improve the coverage and timeliness of all statistics, priority should be given to national accounts and government finance statistics.

In light of this assessment, Participants hereby invite Bosnia and Herzegovina to[3]:

1. Provide well-targeted and temporary pandemic-related fiscal support to the health sector as well as to vulnerable households and troubled but viable firms; provided the economic recovery is well entrenched, return to a debt-stabilising fiscal policy as of 2022 and foresee a gradually improving primary balance in the budget 2022 and in the medium-term fiscal plans. Increase the share of government capital spending in GDP, by measures to improve public investment management and through an accelerated implementation of those investment projects, that have been subject to a clear positive cost-benefit assessment. In order to improve the efficiency of tax collection, ensure an effective exchange of taxpayer information between the country's tax authorities, and in particular create in line with the EU acquis a central (i.e. country-wide) registry of bank accounts of private individuals.
2. Prepare a report on contingent liabilities, with a particular emphasis on those related to the COVID crisis response, and prepare a strategy on how to manage risks related to contingent liabilities. Strengthen the analytical capacities of governmental institutions, in particular the BiH Ministry of Finance and Treasury with a view to improving the preparation and quality of the ERP in line with EU requirements. Invest more significantly in building up the country's statistical capacity for macroeconomic statistics, particularly the harmonised index of consumer prices, regional accounts, labour force survey and government finance statistics, and pursue efforts to improve the coverage and timeliness of all statistics.
3. Maintain a strong financial sector regulatory framework in line with international and EU best practices, ensure sound credit risk management, a transparent display of asset quality, adequate provisioning and close coordination of supervisory activities. Further reduce institutional and legal obstacles to swift and effective NPL resolution, and strengthen the bank resolution framework. Safeguard the integrity of the currency board arrangement and the independence of the central bank.
4. With a view to improve the business environment and strengthen the single economic space, business registration as well as licensing and permitting procedures will be simplified and harmonized across the country. To foster digitalisation of public services and to complement the development of e-Government infrastructure, adopt the law on electronic identity and trust services for electronic transactions with a single supervisory body in line with the EU acquis and ensure that Indirect Tax Authority begins issuing of electronic signatures. Once the 2015 Customs Policy Law will have entered into force, implement the new computerised transit system (NCTS) at national level, as well as the authorised economic operator (AEO) concept.
5. Adopt a comprehensive, country-wide Public Finance Management Strategy with performance-based monitoring and reporting. Create/update in both entities publicly available registers of public enterprises with complete, searchable list of all public enterprises including comprehensive financial statements, audits and organizational information. Establish public enterprises central oversight units in both entities and allocate adequate human resources.

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[3] The representatives of Bosnia and Herzegovina were not able to take a position on two recommendations: i) to "create in line with the EU acquis a central (i.e. country-wide) registry of bank accounts of private individuals" and ii) "to adopt the law on electronic identity and trust services for electronic transactions with a single supervisory body in line with the EU acquis.

6. Strengthen the coordination mechanisms within the country as regards employment policies and establish an inter-ministerial task force involving relevant ministries, their agencies and stakeholders to develop a Youth Guarantee Implementation Plan. Develop a system to monitor and forecast the skills needs in the labour market to facilitate the alignment of the education and training systems and of reskilling and upskilling provision to labour market needs. Improve access to early childhood education and care services towards children/families with vulnerable backgrounds and in rural areas.

Kosovo*

Kosovo submitted its Economic Reform Programme 2021-2023 on 29 January 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been implemented to a limited extent.

The COVID-19 crisis took a heavy toll on Kosovo's economy in 2020. Sluggish growth at the beginning of the year turned into a recession due to the pandemic-related lockdown and travel restrictions. On the back of severely contracting service exports and investment, economic activity plunged by an estimated 6.7% in 2020. Amid high uncertainty, the ERP projects a partial recovery in 2021, on the back of rebounding export services and an extraordinary hike in public investment, and stable GDP growth thereafter, in line with the historical trend.

Falling tax revenues and rising public spending, driven by the economic recovery programme, led to a sharp deterioration of the fiscal balance, with the headline deficit widening to 7.8% of GDP in 2020 from 2.9% in the previous year. The fiscal strategy projects the budget deficit to exceed 7% of GDP in 2021 due to the continuation of crisis-related support measures and a large surge in capital spending. In the following years the budget deficit is set to decline gradually and comply with the ceiling of 2% of GDP prescribed by the fiscal rule (which excludes certain investment categories from the deficit) by 2023.

The key vulnerabilities stem from the pandemic-related uncertainty and political risks. Meeting large financing needs is a challenge, as Kosovo does not have access to international credit markets. While supporting the economy is key in 2021, the commitment to gradually return to the 2% of GDP deficit ceiling in the medium term needs to be underpinned by appropriate revenue and spending measures. Budget revenue relies on a narrow tax base, which is weakened by exemptions and preferential tax rates. Public spending suffers from inadequate targeting and transparency of social transfers and weaknesses in investment management. There is a need to streamline the social security system, including the revision of the war veteran pension scheme, and to establish a coherent, fair and fiscally affordable compensation system for public employment. Public investment would benefit from more coherent muti-annual strategy and more realistic planning. Fiscal risks related to publicly owned enterprises and their investment decisions should be better monitored and included in the budgetary planning. The proper fiscal evaluation and costing of initiatives before adoption is crucial to maintain sound public finances.

The banking sector appears to have weathered the crisis well thanks to entering 2020 with ample capital and liquidity buffers and a low level of NPLs, which will help to mitigate credit losses that are yet to materialise once relief measures are phased out. Credit activity decelerated in 2020, especially in the first half of the year, driven by both supply and demand factors. Despite the crisis, the deposit base continued to rise, which supported the liquidity position of banks. Non-performing loans remained low by peer standards, but as support measures can only prevent the bankruptcies of viable clients, asset quality and thus also banking sector profitability and capitalisation levels are likely to deteriorate going forward. The central bank closely monitored financial stability challenges arising from the crisis and undertook appropriate prudential measures. Still, the central bank's low headcount in core policy areas continues to hinder a further enhancement of the analytical and monitoring toolkit, and its governance appears to have room for improvement.

* 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.

The path of the post-pandemic recovery will significantly depend on the authorities' efforts and ability to address the identified structural challenges and the effective implementation of the economic support packages, including the Economic and Investment Plan for the Western Balkans. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue. As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) formalisation of the economy and low competitiveness of the private sector, (ii) tapping renewable and energy saving potentials and fully opening the energy market and (iii) improving the quality and relevance of the education system to increase employment and mitigate skills mismatches. Persistent widespread informality limits the fiscal space for public spending in priority areas, the development of the private sector and the access for the workforce to adequate levels of social protection and training. Kosovo has a strategy and a corresponding action plan that are designed to address the key underlying causes of informality, however there are delays with the implementation and the reporting of the implementation. Strong political support, effective implementation and close monitoring are required to achieve the desired outcomes, while measures to address the underlying causes of informality related to the business environment should complement the strategy. The lack of energy security gives rise to significant costs for business and represents the biggest obstacle to attracting high-quality FDI. Kosovo is investing in renewables, but the current system of feed-in tariffs needs to be reviewed. Despite positive developments, Kosovo needs to step-up efforts to make use of the potential for energy efficiency and to find attractive alternatives to polluting sources of energy. Effective quality assurance is one of the weakest points of the pre-university education. Tools are missing to monitor and forecast skills needs in the labour market to orient education and training to the needs of businesses. The share of young people not in employment, education or training is high. A series of reforms were started to improve the capacity of the employment service, which is currently insufficiently developed to ensure matching between workers and vacant jobs and the implementation of relevant active labour market policies, including upskilling and on-the-job training. Social dialogue needs to be further developed, in particular in the private sector.

Participants take note of Kosovo's achievements concerning the transmission of national accounts, excessive deficit procedure and harmonised index of consumer prices data. However, data for several statistical domains such as short-term business statistics and research and development are missing. Although important progress was made in 2020, efforts should continue towards a complete set of annual and quarterly national accounts and government finance statistics.

In light of this assessment, Participants hereby invite Kosovo to:

1. Provide well-targeted and temporary pandemic-related fiscal support to vulnerable households and businesses; provided the economic recovery is well entrenched, foresee in the 2022 budget and medium-term expenditure framework a gradual return to the 2% deficit ceiling, according to the fiscal rule definition, by 2023. With a view to ensuring efficient, fair and sustainable public spending, revise the law on public salaries and prepare a review of the social security system, including war veteran pensions. Undertake a review of tax expenditure quantifying the size of the revenue forgone from exemptions and reduced rates.
2. Improve the execution of capital spending by implementing the administrative instructions on the planning, selection, execution and monitoring of capital projects and advancing multi-annual project planning. To reduce the risk of contingent liabilities, improve the financial oversight and accountability of publicly owned enterprises, including their regular quarterly reporting. Take next steps towards establishing an independent body for fiscal oversight, based on the recommendations of an options paper.

3. Maintain a strong financial sector regulatory framework in line with international best and EU practices, ensure sound credit risk management, a transparent display of asset quality, adequate provisioning, and develop a more integrated framework for measuring household indebtedness. Further reduce the remaining institutional and legal obstacles to swift and effective NPL resolution. Ensure the central bank's effective functioning by undertaking an in-depth analysis of the staffing requirements in its key policy areas, especially financial stability and financial sector supervision and filling the vacant positions in the board needed to restore its quorum.
4. Adopt a coherent long-term energy and climate strategy for lowering carbon emissions, including plans for a phase-out of coal and fossil fuels subsidies as committed under the Sofia Declaration. In line with the commitments of the Green Agenda for the Western Balkans: increase energy efficiency incentives for the private sector and households and improve the support schemes for renewable energy projects with the introduction of competitive bidding/auctions; adopt an action plan for the gradual adjustment of energy tariffs reflecting actual costs and providing mitigation measures for vulnerable consumers.
5. Update the action plan of the 2019–2023 National Strategy for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes, and ensure its implementation. Implement incentive measures with an aim to formalise informal employment and businesses, and address tax evasion in identified high-risk sectors in line with the strategy and the action plan. With an aim to prevent evasion of property income tax, improve transparency by publishing all sales prices of real estate property.
6. Thoroughly apply existing quality assurance mechanisms at all levels of education through increased school inspections and effectiveness of quality coordinators, as well as monitoring of study programmes by the Accreditation Agency. Develop a system to monitor and forecast the skills needs in the labour market to facilitate the alignment of the education and training systems and of reskilling and upskilling provision to labour market needs. Establish an inter-ministerial task force involving relevant ministries, their agencies and stakeholders to develop a Youth Guarantee Implementation Plan.