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COVER NOTE

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

In view of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey of 25 May 2018, delegations will find attached the Draft Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, which were endorsed by the members of the EFC and representatives of Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo*, Montenegro, Serbia and Turkey on 15 May 2018.

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* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

Draft

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, 25 May 2018

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 submitted 2018 Economic Reform Programmes (ERPs) of the Western Balkans and Turkey outline the medium-term macroeconomic and fiscal framework as well as structural reforms (affecting areas such as labour markets and education, energy, innovation and the business environment) to enhance competitiveness and long-term growth. Participants regretted that Bosnia and Herzegovina's ERP had been submitted with a significant delay. The programmes cover the period 2018-2020.

Participants took note of the European Council Conclusions of 23 March, which confirmed that enlargement will be addressed by the Council in June 2018. The dialogue on economic governance with the Western Balkans and Turkey is meant to prepare them for their future participation in the EU economic policy coordination. Ownership is key to achieve the results envisioned in the Economic Reform Programmes and the below jointly agreed policy guidance. The dialogue reflects to some extent the European Semester process at EU level.

Participants recalled the commitment to set out a new set of targeted policy guidance to support efforts towards fulfilling the Copenhagen economic criteria. In this context, Participants agreed that the elements of the 2017 policy guidance which had not yet been fully implemented remained valid and needed to be addressed by policymakers in the Western Balkans and Turkey.

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1 Montenegro, Serbia, the former Yugoslav Republic of Macedonia, Albania and 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 2018-2020 on 31 January 2018. The implementation of the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017 has been limited.

The Turkish economy registered very high growth in 2017, despite earlier adverse shocks, as a result of measures taken to stimulate the economy, base effects and strong foreign demand and the projections in the ERP are based on this current positive momentum in the Turkish and global economy. During 2017 a shift in growth drivers from government stimulus to private demand was observed. Private domestic demand is expected to drive economic growth in 2018 with renewed government impetus expected as the elections approach. Inflation expectations have increased and core inflation reached double digits, despite the tightening of the monetary policy stance. The tightening was implemented via increasing the late liquidity lending rate and shifting all funding to the late liquidity window, while the key policy rate remained unchanged. Therefore, the late liquidity lending rate (originally intended for emergency funding) became the effective policy rate. Although Turkey has sufficient fiscal space, public finances have come under pressure in the last two years due to ad hoc budgetary measures on both the expenditure and revenue side. The net trade balance can be expected to turn more negative due to increasing energy prices and the continued growth impulse from the private sector Financing of the sizeable current account deficit continues to rely on volatile types of capital flows, exposing the country to risks stemming from changes in investor sentiment.

The banking sector is stable overall, but headline financial stability indicators might understate underlying vulnerabilities. Credit growth notably to corporates has been buoyant, driven in particular by loans backed by the Credit Guarantee Fund initiated to regain momentum in credit growth as Turkey faced internal and external shocks in 2016. Risks to financial stability continue to stem from the high dependence on external funding and a growing degree of dollarization. The loan-to-deposit ratio remains broadly stable at high levels and a significant part of financing is obtained externally. The share of forex loans to the corporate sector remains significant, which is a tail risk for financial stability, and the share of forex deposits in total deposits increased. Effective from May 2018, the government banned forex borrowing by SMEs that are not naturally hedged against forex risks, and imposed limits on forex borrowing for exporting SMEs. Furthermore, the CBRT is currently setting up a database for monitoring exchange rate risks of large corporations.

Turkey is confronted with a number of challenges to growth and competitiveness. Although it has declined in the last decade, the informal economy is still sizable. More efforts taken to fight against corruption will have a positive impact on the business environment. In addition, Turkey's current institutional capacity and resources spent on R&D and the level of commercialisation of innovation are insufficient to enable its planned transformation process to higher added value production. However, progress has been made in recent years as Turkey implemented some major reforms such as R&D reform package and Intellectual Property Law. Turkey faces substantial labour market challenges, reflected in low participation and employment rates, high numbers of inactive youth, high level of informal work and low qualification level of the workforce. Employment creation support has been strongly expanded However, targeted support to groups most in need such as youth and women needs to be intensified.

Participants welcome that in 2017 Turkey transmitted all relevant annual national accounts data series in current prices and chain-linked volume and the overall high level of data submission in many domains. Participants encourage the regular transmission of annual government deficit and debt statistics and welcome that, since April 2017, Turkey has started to re- transmit EDP notification data tables based on ESA 2010 concepts. Completeness of the tables is good, while efforts are still needed in identified areas. Further effort is also needed in order to complete the

EDP related questionnaire.

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

1. Lower external imbalances in light of high external funding needs constituting a substantial risk for the Turkish economy. Promote domestic savings by incentivising higher private sector savings and by following a sufficiently tight fiscal stance over the medium term in light of external vulnerabilities built up over the years.
2. Increase the prudence and transparency of fiscal policy by (i) making a sufficiently prudent inventory of risks to public finances stemming from Public Private Partnerships and other contingent liabilities (ii) limiting the accumulation of new contingent liabilities reflected in the budget (iii) avoiding ad hoc increases in tax exemptions and subsidies, and (iv) making the medium-term economic scenario more conservative.
3. Focus monetary policy on the pursuit of price stability and ensure that the monetary policy stance is sufficiently tight to bring inflation back to the target band, anchor inflation expectations and increase trust in the local currency. Simplify the monetary policy framework by returning to the main policy rate as the key signalling device for the monetary policy stance in order to increase transparency of monetary policy. Closely monitor asset quality amid buoyant credit growth, especially for loans backed by the credit guarantee fund. Continue addressing possible risks associated with corporate forex borrowing.
4. With a view to improving the business environment, strengthen the rule of law and the judiciary. Further reduce the administrative burden for companies including by shortening the timing and lowering the cost of insolvency procedures through the effective implementation of the amended law on bankruptcy.
5. Adopt the strategy in support of research and development. Encourage private companies' uptake of innovative production processes.
6. Ensure a balanced regulation of the labour market combining flexibility with security including the reform of the severance pay system, and reduce informal employment through, inter alia, increase of inspection capacities, with particular focus on non-agricultural employment. Target support for job creation to youth and women. Focus support to the expanded provision of vocational training on sectors with growth potential and skills needs.

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Montenegro

Montenegro submitted its Economic Reform Programme 2018-2020 on 31 January 2018. The authorities have partially implemented the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017.

Economic growth is projected to decelerate as a result of fiscal consolidation as well as the fading contribution of investment after some large construction works are completed. Net exports are expected to continue strengthening, supported by tourism and the decline of investment-related imports. However, the still large trade deficits and external debt will remain an important risk for the country's external position. As part of the government's ambitious fiscal adjustment plan a series of measures are being adopted to increase budget revenue, contain spending and rebalance the public debt structure in more favourable terms. Montenegro’s economic reform programme relies on achieving strong primary surpluses as of 2020 to set high public debt on a clear downward path. However, recurrent contingent liabilities and the overestimated performance of local government budgets remain key challenges for public finance plans.

The soundness of the banking sector improved and the burden of non-performing loans on banks’ balance sheets continued to decline supported by determined actions of the central bank. However, the NPL ratio in the banking sector still remains elevated, continues to impinge on banks’ profitability and contributes to higher lending rates. Furthermore, while transferring NPLs from banks to the so-called factoring companies have relieved banks’ balance sheets, this did not address the problem of high corporate indebtedness, with potential implications for private sector activity. This calls for a more comprehensive approach towards NPL resolution and debt restructuring, which would also need to address obstacles outside the remit of the central bank.

The country’s structural reform needs remain concentrated on the labour market, and human and physical capital. Labour market performance is poor, characterised by high youth unemployment, low participation of women and high long-term unemployment. Employment services and active labour market policies continue to be weak and still lack focus on incentivising work. There is a need to address the root causes of the skills mismatch in vocational and higher education. There are significant transport bottlenecks which need to be addressed in a fiscally sustainable and transparent manner, with due attention given to regulatory reform and network maintenance. Good progress was made on opening up the energy market to competition. More needs to be done to strengthen rail regulatory authorities’ capacities and independence in order to ensure the practical market opening. The high price and low availability of high-speed broadband is not supportive of economic growth and innovation. Local companies have low goods export performance and are predominantly focused on the local market and non-tradable sector. Boosting investment in research and innovation and strengthening the public-private sector cooperation, based on reliable statistical data, can help address Montenegro's low level of competitiveness in this area. Strengthening the rule of law, reducing the informal sector and tackling corruption remain important to further improve the business environment.

Participants welcome the improved completeness this year of data submission for annual national accounts. Regarding energy statistics, Montenegro made a huge effort to provide historic time series and the latest data. Nonetheless, quality of data submission in the areas of government deficit and debt statistics needs further improvement and annual data for annual government finance statistics is still missing. At end-2017, Montenegro published Labour Force Survey (LFS) data in compliance with EU Regulation 0577/1998 for the first time. Participants also note improved provision of STS indicators on industrial turnover.

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

1. Fully implement the July 2017 fiscal strategy. Take additional fiscal measures if necessary to achieve the debt and deficit targets as outlined in the 2018 ERP. Establish adequate budget allocation to accommodate contingent liabilities related to unfavourable court cases. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultation with stakeholders, including the EU.
2. Gradually reduce public spending on wages and pensions as a share of GDP. To this end, implement the new optimisation plan of the public administration reform, including local self-government and public institutions, and prepare pension reforms that would change the valorisation and indexation of pensions and tighten eligibility for early retirements.
3. Continue efforts aimed at NPL resolution and corporate debt restructuring, focusing also on loans held outside the banking sector and underlying obstacles outside the remit of the central bank. Establish a framework for the recovery and resolution of credit institutions. Consider conducting asset quality reviews in the banking sector and options for enhancing the emergency liquidity assistance framework. Enhance the accountability and transparency of macroprudential policy by publishing a document outlining the central bank competences, objectives and instruments in this area.
4. Based on a mapping of infrastructure and analysis of market interests, develop a comprehensive action plan on broadband roll out and coverage, and implement the broadband cost reduction measure in line with EU Directive 2014/61. Ensure the collection and delivery of statistical data on research and development, and innovation. Develop a model for the introduction of fiscal incentives for the research and innovation sector in line with EU state aid rules.
5. Adopt legislation on concessions and public private partnerships in line with EU rules and best practices accompanied by an action plan for institutional capacity building in this area. Ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening of the rail market.
6. Review active labour market policies in order to improve their coverage and effectiveness, in particular for youth, women and the long-term unemployed. Ensure better coordination between employment activation measures and social benefit schemes. Increase enrolment in vocational and higher education corresponding to labour market needs.

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Serbia

Serbia submitted its Economic Reform Programme 2018-2020 on 31 January 2018. The authorities have partially implemented the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017.

Economic growth is forecast to pick up markedly following weather-related supply shocks in 2017. Growth is expected to be driven by private and public consumption, while investment and export performance are set to remain solid. Monetary policy was eased further, reflecting lower than expected developments in headline and core inflation. In the last four years, the general government budget turned from a very high deficit to a surplus. However, fiscal risks are elevated and government debt is still relatively high at around 60% of GDP. In addition, the successful budget consolidation masks an unfinished reform agenda of the public sector. Maintaining a proper macroeconomic policy mix and continuing difficult structural reforms remains a challenge.

The banking system remains well capitalised and liquid. The implementation of the NPL resolution strategy is yielding positive results. The ratio of NPLs to total loans has declined considerably on account of write-offs and sales, and credit growth appears to have resumed, particularly for households. However, NPL levels are higher in some sectors, although they are fully covered by regulatory reserves for estimated losses, and in those state-owned banks for which the process of restructuring and privatisation is progressing slowly. The measures undertaken by the authorities under the dinarisation strategy, coupled with increased macroeconomic stability and lower interest rates have had some positive impact on strengthening the use of the local currency. But euroisation remains stubbornly high, in the case of household deposits and corporate loans.

Sustainable growth depends on increased levels of public and private investment. Support to attract FDI is not matched by adequately funded grant measures or diverse financial instruments to respond to the needs of SMEs. The business environment has improved as red tape has been cut, but it remains unpredictable due to corruption, high share of informal economy and parafiscal charges. In particular in the energy sector, these companies could still turn into a fiscal threat. The big and non-reformed publicly owned enterprises represent unfair competition. Despite recent improvements, low employment and high and long-term unemployment persist without adequate support fostering labour market integration. The effectiveness of the social assistance system in reducing poverty is weak. Further attention should be devoted to the fight against undeclared work.

Participants take note of Serbia's increased compliance in the area of annual national accounts as well as the submission of quarterly national accounts data within the legal deadlines. Serbia reported all required annual national accounts output and expenditure variables in current prices, chain-linked volume and previous year prices for the years 1995-2016 and transmitted data on total population. However, significant progress is still needed to transmit data on employment, compensation of employees or gross wages and salaries. Participants encourage Serbia to further improve Annual Sector Accounts compilation sources and methods and to provide financial accounts. Serbia is encouraged to improve submission of quarterly government finance statistics.

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

1. Use any revenue over performance in 2018 for debt reduction. Target a balanced budget over the medium term, in order to lock in recent fiscal consolidation gains and create sufficient buffers against fiscal risks. Adopt a credible and binding system of fiscal rules, capable of anchoring fiscal policy.

2. Further improve the composition of government spending by reducing non-interest current expenditure and increasing capital spending as a share of GDP over the medium term. In order to better plan and execute public investments, develop a single mechanism for prioritising and monitoring all investment regardless of the source of financing.

3. Conduct monetary policy in line with achieving the inflation target. Consider to gradually allow for more exchange rate flexibility as macroeconomic stability is cemented. Implement the remaining action points from the NPL resolution strategy and finalise the privatisation process of the remaining state-owned banks. Continue to promote the use of the local currency inter alia by maintaining a favourable treatment of dinar reserve requirements compared to those in foreign currency and by fostering the development of interbank markets and secondary markets for government securities.

4. Gradually adapt electricity tariffs so they reflect real costs including necessary investments to upgrade the energy network and to meet environmental standards. In parallel, increase investments in energy efficiency. Finalise the unbundling of state-owned enterprises alongside accelerating their restructuring, in particular Srbijagas and EPS.

5. Use findings of the smart specialisation exercise to finalise a new industrial strategy and ensure that all instruments of support to companies are in line with state aid rules. Implement the law on fees so that parafiscal charges will be predictable and based on a fee-for-service principle. Ensure predictability and risk based control of phytosanitary checks at the border.

6. Reduce the high non-wage labour cost of jobs at the lower sections of the wage distribution. Increase substantially the inclusion of unemployed in active labour market measures, in particular women and Roma. Involve closely all relevant actors for the country-wide roll-out of dual learning. Accelerate the envisaged reforms for better targeting of social assistance. Further attention should be devoted to tackling undeclared work.

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The former Yugoslav Republic of Macedonia

The former Yugoslav Republic of Macedonia submitted its Economic Reform Programme 2018-2020 on 30 January 2018. The authorities have partially implemented the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017.

The economy was stagnant in 2017 as the country was affected by prolonged political uncertainty in the first half of the year, which caused private and public investment to drop sharply. Monetary policy has remained accommodative. At the beginning of 2017 the main policy rate was gradually normalised after the tightening in the previous year, on the backdrop of the political turmoil. Amid a favourable external position, rising confidence and coupled with moderate inflation, in the first quarter of 2018 the main policy rate was additionally reduced. With domestic uncertainty now receding and the external economic environment improving, the economic reform programme expects growth to accelerate gradually. The programme envisages a decline in fiscal deficits over the next years, but contains limited information on supporting consolidation measures. The debt-to-GDP ratio is projected to rise this year and next, followed by a moderate decline in 2020. However, in light of sustained primary fiscal deficits, large upcoming debt refinancing requirements, and continued financing needs of state-owned enterprises, debt stabilisation remains a challenge. The new government has made great strides in improving fiscal transparency and in tackling the issue of unpaid public sector liabilities.

The banking sector remains stable, with sound solvency, low funding risks and healthy profitability. Non-performing loans remain well-provisioned and a large part of them has been already moved to off-balance sheet positions due to accounting write-offs. However, excluding write-offs, the NPL ratio in the banking sector remained considerable at the end of 2017, which might still impede credit extension. Furthermore, notwithstanding improvements, the sizeable euroisation in the banking sector continues to pose a latent financial stability risk. These traits call for an acceleration of the work on finalising and adopting comprehensive strategies for NPL resolution and strengthening the use of the local currency, which would need to also address the challenges in these areas outside the remit of the central bank.

Major structural obstacles to growth and competitiveness include a sizable informal sector and corruption with a concomitant underdeveloped formal private sector, a lack of systematic and efficient law enforcement with an insufficient institutional capacity of civil courts for commercial dispute settlement, and a non-transparent and often unpredictable regulatory framework and system of para-fiscal charges. The significant improvements in the public financial management (PFM) framework are a positive step and it is now critical for the comprehensive PFM reform framework to be fully implemented. Despite some improvements, low employment and high unemployment persist, especially for youth, the low-skilled and women. Low quality of the education system and its relevance for the labour market needs remain to be addressed.

Participants welcome the transmission of output, expenditure and income variables, the provision of regional accounts, financial accounts (balance sheets) and government deficit and debt statistics and the high quality of Europe 2020 indicators. Providing annual data for ESA tables 2 and 9 (covering the years 2011-2014, ESA 2010 methodology) and annual financial accounts ESA tables 0720 and 0725 (covering the years 2013-2015, ESA 2010 methodology) was a positive step. EDP notifications are transmitted regularly and table 2 coverage improved but there are still gaps, notably for tables 3 and 4. Punctuality of quarterly national accounts transmission should be further improved, and further efforts are necessary, in particular with respect to full ESA 2010 implementation. Greater completeness and timeliness of annual national accounts transmission according to ESA 2010 is encouraged.

In light of this assessment participants hereby invite the former Yugoslav Republic of Macedonia to:

1. Develop a proper medium-term fiscal consolidation strategy. Stabilise the public debt ratio by pursuing a sufficiently tight fiscal stance while protecting capital spending.
2. Streamline and better target social spending and agricultural subsidies. Reduce public sector payment arrears and develop an arrears prevention strategy. Take the necessary organisational steps in view of improving tax collection. Adopt the organic budget law with a set of fiscal rules and establish an independent fiscal council to assist in their enforcement.
3. Conduct monetary policy consistent with the exchange rate peg, using available scope within this framework in line with safeguarding price stability. Adopt and implement a comprehensive NPL resolution strategy, addressing all underlying obstacles also outside the remit of the central bank, with the involvement of all relevant stakeholders. Adopt and implement a comprehensive strategy for fostering the use of the local currency, with the participation of all relevant stakeholders.
4. Prepare risk assessments focusing on sectors and branches most vulnerable to informalities and identify and apply appropriate corrective measures.
5. Clarify the mandate of each inspectorate to avoid overlap and put in place and apply transparent and consistent procedures. Create a register of para-fiscal charges on central and local levels that clearly states the purpose of each charge and make it publically available. Strengthen the institutional capacity of civil courts to uphold contracts and handle commercial disputes within a reasonable time and at reasonable costs.
6. Modernise the education system at all levels by further improving the infrastructure, curricula and teacher qualification. Pursue the reform of the VET system to facilitate school-to-work transition. Facilitate women's access to the labour market and ensure sufficient capacity of the Employment Service Agency for implementing the Youth Guarantee. Adopt the law on social protection to better target those at risk of social exclusion. Increase enrolment in pre-school education.

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Albania

Albania submitted its Economic Reform Programme 2018-2020 on 31 January 2018. The authorities have partially implemented the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017.

Albania's economic expansion is expected to continue in 2018-2020 on the back of stronger domestic demand. Private consumption is seen as the major growth driver in the context of an improving labour market, rising confidence, and favourable financial conditions. The projections see investment as an additional source of growth although at a more moderate rate than over the past two years. There is a risk that net exports will subtract from GDP growth in view of stronger domestic demand. Monetary policy remained accommodative in view of inflation staying below target, and the budget deficit stabilised at a moderate level in 2017. Fiscal consolidation plans have been back-loaded compared with last year's programme which will slow down the envisaged reduction of the still high public debt-to-GDP ratio.

The banking sector stays liquid and well-capitalised and risks to financial stability remain overall muted. The ratio of non-performing loans (NPL) decreased considerably, which helped to contain credit risk, but still remains elevated and an obstacle for further credit extension. There was some progress as regards de-euroisation on the lending side, while the share of foreign exchange deposits in total deposits continued to grow. Following the approval of the national strategy (Memorandum of Cooperation) on de-euroisation in April 2017, the Bank of Albania approved some measures, including increasing the Reserve Requirements Rate for banks' fx-eligible liabilities. A license was granted to open the first private stock exchange to contribute to the deepening of the currently very shallow capital markets, which launched its operations at the end of February 2018.

Structural obstacles to growth and competitiveness include still unclear land ownership and insufficient enforcement of property rights, a high level (though decreasing) of informality and corruption despite progress achieved through judicial reform, an excessive regulatory burden and unpredictability in the judiciary system, which act as a discouragement to both foreign and domestic investment. The lack of a comprehensive cadastre hinders the development of the agricultural sector, tourism, infrastructure improvements, access to finance, amongst other things. Creating favourable conditions for private investment would facilitate much-needed investments in infrastructure. The completion of the liberalisation of the energy market is important. There has been some limited progress in unbundling the electricity and gas markets with the preparation of an unbundling plan and the establishment of a new gas company. Skills mismatch, disincentives to work and weak employment support contribute to high youth unemployment and low female labour market participation. There is no comprehensive approach to addressing the high incidence of undeclared work. Efforts to address these challenges have been limited.

Participants take note that Albania made significant progress in some areas, such as the submission of data for Europe 2020 indicators, but did not improve its compliance to the annual national accounts main aggregates requirements as regards completeness as 2016 annual data for expenditure have not been transmitted. Concerning population and employment, Albania transmits only total population data for the complete time series. Non-financial sector accounts and financial accounts data have not yet been provided. Participants took note of progress in the submission of government deficit and debt statistics. Participants recommend increased efforts to meet the requirements of the EDP notification. Further efforts are needed to fill in the gaps for infra-annual statistics, as well as for regular transmissions of quarterly government finance statistics.

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

1. Introduce further fiscal consolidation measures with a view to meeting the indicated medium-term target of reducing public debt to below 60% of GDP in 2021.
2. Support fiscal consolidation by (i) strengthening tax administration further; (ii) broadening the tax base and avoiding new tax exemptions; (iii) fully implementing the valuation-based property tax; and (iv) ensuring that new Public-Private Partnerships are only contracted on the basis of solid cost-benefit analyses and fiscal risk assessments.
3. Conduct monetary policy in line with reaching the inflation target. Increase the transparency of monetary policy communication by publishing time series on core inflation and inflation expectations. Implement the remaining measures of the NPL resolution strategy, also with a view to addressing factors hampering access to finance for corporates. Based on regular analysis of relevant indicators and impact assessment, explore other measures in line with the Memorandum of Cooperation to increase the use of the national currency at all levels.
4. Ensure effective liberalisation of the energy market and functioning of the power exchange. Adopt the legal provisions to effectively implement the national energy strategy and further broaden the energy supply mix, focussing on incentivising energy efficiency and renewable energy production beyond hydropower.
5. Further strengthen the process of cadastral, land and property registration, including clarification on land ownership, with a special emphasis on de-fragmentation and consolidation of agricultural land, and swift case handling in case of court procedures. Reinforce measures to finalise the property restitution and compensation process.
6. Ensure sufficient capacities for the implementation of employment policies, in particular for youth and women, and improve linkages between active and passive employment measures. Address undeclared work, including by strengthening the labour inspectorate. Support the development of basic education and increase the investment in initial teacher training.

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Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2018-2020 with a significant delay on 2 March 2018. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017 has been limited.

Economic activity is expected to accelerate slightly during the programme period. The main growth-supporting factors are projected to be investment, which is seen as picking up after performing weakly for years, and private consumption, which will benefit from rising employment and moderate inflation. Unemployment is seen to decline on the back of stronger growth and active labour market measures, but will still remain high. The programme expects the general government fiscal balance to register surpluses in 2018-20, based on a freeze in spending, while revenues are expected to increase only moderately. However, spending on public investment and education is planned to drop faster than most other expenditure items, which is not conducive to growth. Weaknesses in fiscal governance include limited administrative capacities for medium-term analysis and planning.

Regarding financial stability, still sizeable levels of non-performing loans (NPLs) impact on banks' profitability and constitute an obstacle for credit extension. Authorities have adopted a set of legislative reforms that should facilitate the removal of NPLs from banks' balance sheets. A law on deposit insurance is still pending, which is a crucial element of the bank resolution framework. Approving the complete legal package entailing the establishment of a comprehensive bank resolution framework would buttress the legal underpinnings of the financial system, ensuring that coordination among bodies entrusted with resolution is sufficiently strengthened.

Major structural obstacles to growth and competitiveness include the absence of a common economic space including non-recognition of business registration across the country, a large and inefficient public sector, as well as a fragmented regulatory environment, widespread informalities, weak access to finance for some segments of the economy and corruption affecting the business environment. Strong coordinated and continued political support is needed to tackle these challenges and to proceed with the adoption of country wide strategies in important sectors such as energy, public finance management and quality infrastructure. The absence of full implementation of the law on electronic signature constitutes a severe barrier to further progress in expanding electronic government infrastructure and e-services. Despite some positive developments, significant labour market challenges remain and structural unemployment and low activity rates persist. Weak activation measures are coupled with disincentives to work, untargeted social spending and unsupportive labour taxation. The quality of the education system remains low and insufficiently corresponds to labour market needs.

Participants took note that Bosnia and Herzegovina started to report annual national accounts data according to ESA 2010 methodology in May 2017. However, there are reporting gaps in some areas, such as regional accounts, Labour Force Survey Data and quarterly HICP data. There are reporting gaps in balance of payments and international investment position data. Participants strongly recommend that Bosnia and Herzegovina improves compliance with data submission.

In light of this assessment, and also taking into account the Reform Agenda, Participants hereby invite Bosnia and Herzegovina to:

1. Improve the current medium-term fiscal planning framework to become an effective policy planning tool for public finance. Strengthen the analytical capacities of the various stakeholders producing macro-fiscal analysis and forecasts. In order to better support policy analysis, improve the provision of timely and exhaustive statistics, in particular government finance, national accounts and labour market statistics. Strengthen the country-wide public debt management capacities, at all levels, in particular the cooperation and flow of adequate and full information from all data providers.
2. Create fiscal space for public investment by containing spending on public consumption and improving the targeting of social spending. Furthermore, take steps to reduce public-sector payment arrears and lower the tax burden on labour, including social security contributions while ensuring sustainable public finances.
3. Safeguard the integrity of the currency board arrangement as the anchor of monetary stability. Enhance further the analytical and forecasting capacity of the CBBH, and develop its toolkit by establishing a bank lending and inflation expectations survey. Follow up on on-going legislative changes and develop a comprehensive strategy fostering the resolution of NPLs to help remove supply-side bottlenecks to credit extension. Strengthen the bank resolution framework by ensuring sufficient coordination among the bodies entrusted with resolution. Develop a macroprudential framework so as to mitigate systemic risk in the financial system.
4. Adopt a credible and relevant country-wide Public Financial Management strategic framework with a performance based monitoring and reporting system. Adopt a country-wide energy sector reform strategy and a legal framework in compliance with the Energy Community Treaty.
5. Simplify and harmonise business registration procedures between entities. Introduce e-payment services on taxation and fully implement the law on electronic signature.
6. Reduce the tax wedge and disincentives to work. Ensure better coordination between employment activation measures and social benefit schemes. Increase enrolment in pre-school education. Undertake a review of secondary and higher education enrolment policies in order to improve their links with the labour market needs.

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Kosovo [*]

Kosovo submitted its Economic Reform Programme 2018-2020 on 29 January 2018. The authorities have partially implemented the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2017.

Economic growth continued in 2017, supported by strong export growth and investment. Economic activity is forecast to accelerate with growth rates above Kosovo's long-term average on the back of a planned pick-up in public investment and favourable external environment. Despite the higher-than-projected cost of the recently introduced war veteran pension scheme, Kosovo has preserved the sustainability of public finances. However, in the context of low, but increasing public debt, the rise in current expenditure needs to be contained, notably through better prioritisation and planning of different policies. The budget deficit was lower than planned in 2017 and closely in line with revised budget estimates. The 2018 projections of higher budget revenue rely mainly on improvements in revenue collection and increased economic activity. Capital spending targets seem overly ambitious, in particular as administrative capacities to prepare and execute investment projects remain limited.

Near-term challenges to financial stability stemming from the banking system appear contained, with the sector characterised by high capitalisation and liquidity buffers. Credit growth remained strong throughout 2017, in particular for households, and gathered pace towards the end of the year, although financial intermediation remains low. Lending in particular to corporates continues to be held back by a number of legal and institutional factors. Lower interest rates coupled with the increasing activity of the Credit Guarantee Fund have partially improved overall access to finance for businesses.

Major structural obstacles to growth and competitiveness include widespread though decreasing informalities in the economy, an unreliable energy supply, corruption and the weak rule of law as well as lengthy collateral execution and contract enforcement procedures notably as a result of considerable court backlogs. Some improvements were seen in the business environment, in particular as regards starting a business, getting credit and resolving insolvency, but private sector development continues to be hindered by the unfair competition of the informal sector. Firms still face the most frequent power outages in the region and there is a lot of potential to improve energy efficiency. Kosovo's labour market performance is not improving as the majority of the working age population remains inactive. Labour market integration of young people is hampered by weak education outcomes. Social challenges are significant.

Participants take note that Kosovo transmitted most of the main annual national accounts output components in current and previous year prices according to the ESA 2010 methodology. However, there are substantial gaps with data submission in other areas, including regional accounts and government deficit and debt statistics, as well as some of the Europe 2020 indicators. There also data gaps in the submission of infra-annual data. Participants strongly recommend that Kosovo improves compliance with data submission.

[*] 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.

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

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.
2. Complete the war veteran certification and reclassification processes with a view of decreasing costs of the war veteran pension scheme in line with the current legislation. Strengthen institutional capacities at central and local government levels for multiannual investment planning, and investment project preparation and management in order to improve the execution of capital spending.
3. Continue expanding the central bank's analytical toolkit by developing an inflation expectations survey. Ensure that central bank purchases of government bonds and bills on the secondary market do not amount to de facto central bank financing of the government. Further address the underlying legal and institutional factors hampering access to finance for SMEs, while monitoring carefully high lending growth to households. Finalise the bank resolution and the crisis management frameworks to strengthen the overall resilience of the banking sector.
4. Adopt the Energy Efficiency Law and establish the Energy Efficiency Fund. Adopt energy efficiency incentives to the private sector and households. Advance in the deregulation of electricity supply prices and conclude a study with the aim of adopting a plan for the gradual adjustment of energy tariffs to reflect actual costs.
5. Adopt the new Strategy and Action Plan 2019-2022 to fight the informal economy that should include qualitative and quantitative targets.
6. Monitor the implementation of the youth employment action plan and increase the scope of active labour market measures in particular for women. Conduct a skills needs analysis for identification of priority sectors to inform the review of occupational profiles and curricula. Complete the necessary steps for the introduction of the general health insurance scheme. Increase enrolment in pre-school education.

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As regards statistics, Participants underlined the growing importance of reliable, up-to-date data, in line with the EU acquis, and therefore welcome the 2018 Progress Report on the Action Plan on Economic, Monetary and Financial Statistics for the Western Balkans and Turkey. Participants took note that there has been progress towards achieving the objectives of the Action Plan across the board since 2017. Nonetheless, gaps in data submission persist. Full implementation and a higher degree of compliance therefore continue to be of utmost importance.

Overall, Participants underlined their commitment to this surveillance process which should ensure a continued anchoring of medium-term economic programmes and commitment to structural reforms by the Western Balkans and Turkey. Participants encouraged the Western Balkans and Turkey to make further progress with respect to their macroeconomic, budgetary and structural policies. Participants also noted the links between the progress on rule of law/fundamental freedoms and the improvement in economic governance and the judiciary system. The dialogue will continue in 2019, including on the implementation of these conclusions.