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

EUROPEAN
COMMISSION

Brussels, 11.4.2025
SWD(2025) 104 final

**COMMISSION STAFF WORKING DOCUMENT**

**ECONOMIC REFORM PROGRAMME**

**OF**

**KOSOVO***
**(2025-2027)**

**COMMISSION ASSESSMENT**

**** 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.***

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## 1. EXECUTIVE SUMMARY

**In a rather optimistic scenario, Kosovo's economic reform programme (ERP) expects GDP growth to accelerate markedly, mainly on the back of a robust increase in private consumption and public investment.** Kosovo's economy remained resilient in 2024, with an annual output growth of 4.4%, up from 4.1% in 2023. A strong expansion of household consumption and public investment were the key growth drivers. The ERP's baseline scenario projects GDP growth to accelerate to an average of 6.3% in 2025-2027, which is well above the historical trend. In particular, the strong increase in public investment is likely to face constraints, given weak planning and insufficient implementation capacity which led to recurring under-execution of public investment projects. Major downside risks to this outlook stem from geopolitical tensions, less dynamic growth in Kosovo's main EU (and non-EU) trading partners, an acceleration of emigration flows following the EU visa liberalisation and lower-than-expected financial inflows from the diaspora.

**The headline deficit remained small in 2024 but is expected to increase markedly in line with an ambitious surge in public investment, while the programme ensures full compliance with the deficit rule in 2025-27.** In 2024, the strong increase in public capital spending - which however fell short of budget plans - outpaced high revenue growth, and the headline budget deficit marginally rose to 0.3% of GDP. The 2025 budget expects the headline deficit to rise to 2.8% of GDP, mainly through an arguably very ambitious further surge in public investment. Nevertheless, the deficit (according to the fiscal rule definition) would not exceed the prescribed ceiling of 2% of GDP in 2025-2027. The ERP expects the headline deficit to remain unchanged in 2026 and to fall to 1.8% of GDP in 2027. The low public debt ratio is projected to increase but remain slightly below 25% in 2027. The domestic public debt investor base remains narrow, but the obtainment of a sovereign credit rating for the first time in April 2024, could help Kosovo access international debt markets in the near future.

The main challenges facing Kosovo are the following:

- **The deficit rule will provide an anchor for fiscal policy but further reforms could support public finances.** Containing current expenditure through streamlining social transfers remains essential. Compliance with the 2% deficit ceiling over 2025-2027 could also be strengthened through policies to broaden the revenue base. The approval and publication of the review of existing tax exemptions and preferential tax rates as well as the reduction of loopholes and exemptions through amendments to tax legislation would help improve revenue mobilisation. Reducing blanket allocations would not only support fiscal discipline, but also enhance budgetary transparency and accountability.
- **The significant planned increase in public investment requires comprehensive reforms to improve project planning and implementation.** Despite authorities' continued efforts, Kosovo has made limited progress in strengthening public investment management. Concrete steps, such as those recommended under the IMF's updated Public Investment Management Assessment, could further improve the execution of capital spending. Fiscal risks related to publicly owned enterprises (POEs) could be mitigated by improving their governance and financial oversight and accountability. This can be advanced by steps such as approving and publishing annual performance reports for POEs and by adopting amendments to the POE Law.
- **Key structural bottlenecks hinder Kosovo's competitiveness and inclusive growth.** Persistent structural obstacles such as the high administrative burden, a large backlog of cases of commercial disputes, and limited access to finance create significant challenges

for businesses and investors, undermining fair competition and economic growth. The large informal sector reduces budget revenues, discourages investment and hinders business development. Energy supply remains insufficient and unreliable, increasing significantly costs for businesses and straining public finances. The education system does not adequately equip students with the skills demanded by the labour market. The latter is marked by low participation and still high unemployment rates, particularly among women and young people. Weak labour market outcomes continue to drive high levels of emigration. These challenges are being addressed through key structural reforms outlined in Kosovo's Reform Agenda under the Growth Plan for the Western Balkans.

**The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2024 has been partial.** The spending structure slightly improved compared to 2023, with a small increase in the share of public capital spending. Compliance with the fiscal rule's deficit ceiling of 2% of GDP is expected to continue in 2025. The increase in public-sector salaries in 2024 was higher than the nominal GDP growth in 2023 and the public wage bill rule was slightly breached. The 2025 budget includes a blanket allocation which is slightly lower compared to the 2024 budget. Tax revenue grew strongly, partly due to improved tax compliance and some formalisation gains, but the review of tax exemptions has not been published yet. Despite the improved execution rate in 2024, public investment management remains a major weakness. Financial oversight of POEs has improved but amendments to the POEs' law to improve their corporate governance are still pending.

## 2. ECONOMIC OUTLOOK AND RISKS

**Kosovo's economic growth accelerated in 2024 on the back of stronger private consumption and public investment.** Real GDP growth accelerated to 4.4%[1] in 2024, from 4.1% in 2023. The key factor behind the slight pickup was a stronger expansion of household consumption, fuelled by higher bank lending and rising wages and real disposable incomes. Moreover, an acceleration in gross fixed capital formation, mainly driven by a strong increase in public investment, supported growth. A slowdown in real exports growth coupled with an uptick in imports, resulted in a negative contribution of the external sector to growth. At the same time, diaspora-related inflows provided less support to growth; the share of net inflows of remittances in GDP dropped moderately.

**The ERP's baseline scenario projects a robust acceleration in real GDP growth in 2025-2027.** Real GDP growth is projected to increase by 5.6% in 2025 and to further accelerate to 6.4% and 6.7% in 2026 and 2027, respectively. This is well above historical growth rates, averaging at 4.2% over 2015-2023. The ERP expects that the growth acceleration will be largely driven by a further pick up in private consumption growth in 2025 (to 5.5%) and public investment. Household consumption looks set to benefit from higher bank lending and real disposable income, the latter on the back of: (i) an expected acceleration in the growth of remittances inflows, (ii) another sharp increase (effective from 1 October 2024) in the minimum wage to EUR 350 per month up from EUR 264[2]. (iii) the government's decision in October 2024 to raise all pensions by 20%, (iv) higher public-sector salaries, (v) a doubling of the children allowance scheme to around EUR 100 million, effective from August 2024, and (vi) subdued inflation. The ERP projects private consumption growth to moderate to a still vigorous 4.7% on average in 2026-2027, although the key reasons for this are not described in the programme. Gross fixed capital formation is set to increase by 6.6% y-o-y in 2025 and remain buoyant in 2026-2027 at an average growth rate of around 6%. This is mainly due to a surge in public investment (13.4% in 2025) on the back of faster implementation of existing projects, benefiting from recent government initiatives[3] to improve public investment management. Private investment is also expected to rise by 4.4% y-o-y, on the back of a capital increase in the Kosovo Credit Guarantee Fund, providing guarantees for loans to small and medium-sized enterprises. Public consumption growth is projected to accelerate to 5% in 2025 due to the planned increase in public-sector salaries as well as expenditure related to parliamentary and municipal elections, before slowing to 2.1% on average in the following two years. Real exports are set to increase by 6.1% in 2025 and continue growing strongly, by 7.8% on average in 2026-2027. In line with the forecast robust increase in domestic demand, imports are expected to grow by nearly 6% in 2025. As a result, the ERP projects net exports to still provide a large negative contribution (-1.8 pps.) to GDP growth in 2025. In 2026-2027, decelerating import growth (down to 3.7% on average) is expected to turn net exports'

[1] Macroeconomic and fiscal estimates and forecasts covering the period 2024-27 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2024 have been taken from the relevant national sources (Kosovo Agency of Statistics (KAS), the Ministry of Finance, Labour and Transfers (MoFLT) and the Central Bank of Kosovo (CBK)).

[2] The latter amount had come into force on 23 August 2024, following the Constitutional Court's ruling on the Law on Minimum Wage.

[3] The authorities have been: (i) implementing the administrative instruction approved in May 2023, requiring budget organisations to include expropriation costs as part of their project envelopes; (ii) ensuring that technical evaluation and documentation on new externally-financed projects is finalised before signing the corresponding financial agreements; and (iii) prioritising small projects that require less procedures and less coordination with stakeholders.

contribution to growth positive. The programme expects the output gap to remain negative in 2025 and turn positive thereafter, as real growth is projected to exceed the potential growth rate (estimated at 6.6%).

**Amid high levels of economic uncertainty, the ERP's baseline scenario looks overly optimistic.** GDP growth rates for 2025 and 2026 have been markedly revised upward from the previous year. In particular, the robust increase in public investment growth seems aspirational and is not backed by concrete measures in the programme to address persistent weaknesses in the planning, selection and management of public investment. A highly uncertain economic environment may not bode well for significantly stronger private investment. The ERP itself highlights rising macro-fiscal risks due to a less favourable external environment and Kosovo's economic ties with international partners through external trade, foreign direct investment and remittances inflows. Geopolitical and trade tensions, as well as sluggish economic activity in the euro area might cause a further slowdown in remittances inflows and weaken external demand. Domestically, significant risks stem from outdated power generation capacity and high energy import costs, which may result in new power shortages and increased energy subsidies. Emigration flows might accelerate in the wake of the EU visa liberalisation, applicable from January 2024. The ERP's 'low growth' scenario results in an average annual growth rate of 5.3% in 2025-2027, which is still much above the historical average growth rate. The scenario's main assumptions are an under-execution of public investment, lower external demand and a decline in remittances.

*Table1:*

**Kosovo - macroeconomic developments**

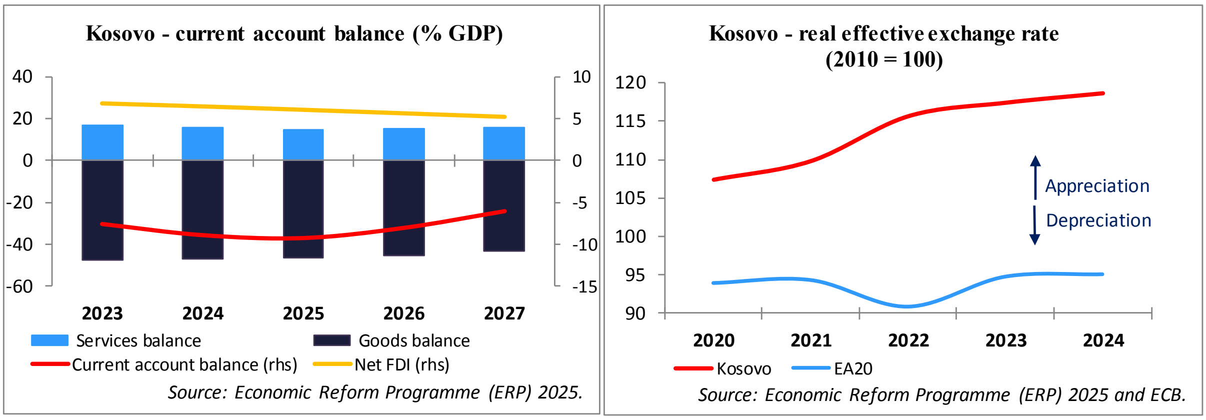
| | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|
| **Real GDP** (% change) | 4.1 | 4.5 | 5.6 | 6.4 | 6.7 |
| *Contributions:* | | | | | |
| **- final domestic demand** | 4.9 | 6.0 | 7.4 | 6.2 | 6.0 |
| **- change in inventories** | -0.2 | -0.1 | 0.0 | 0.0 | 0.0 |
| **- external balance of goods and services** | -0.6 | -1.5 | -1.8 | 0.3 | 0.8 |
| **Employment** (% change) | : | : | : | : | : |
| **Unemployment rate** (%) | : | : | : | : | : |
| **GDP deflator** (% change) | 4.6 | 2.0 | 1.8 | 1.5 | 1.6 |
| **CPI inflation** (%) | 4.9 | 1.6 | 1.8 | 1.6 | 1.6 |
| **Current account balance** (% of GDP) | -7.6 | -9.0 | -9.3 | -8.1 | -6.1 |
| **General government balance** (% of GDP) | -0.2 | -0.4 | -2.8 | -2.8 | -1.8 |
| **Government gross debt** (% of GDP) | 17.5 | 16.5 | 21.1 | 23.0 | 24.0 |

*Source: Economic Reform Programme (ERP) 2025.*

**After falling sharply in 2024, the ERP expects annual inflation to roughly stabilise in 2025-2027 with non-negligible domestic and external upside risks.** Following a further deceleration in the last quarter of the year, annual consumer price inflation averaged 1.6% in 2024, well below the 4.9% rate registered in 2023, while it inched-up to 1.7% in February 2025. The key driver of disinflation was lower commodity prices in international markets. Core inflation remained somewhat higher at an annual average of around 3% in 2024. The ERP expects average annual inflation to hover at 1.7% over the programme period, on the back of stabilising import prices. The ERP's inflation projection is slightly more optimistic than the IMF forecast of an average annual inflation rate of 2% in 2025-2027. The programme rightly acknowledges the external risk of an intensification of the war in Ukraine and the fallout from this on commodity prices and external demand, as well as other geopolitical tensions (such as those in the Middle East). This would leave Kosovo exposed to renewed inflationary pressures caused by higher import prices for food, agricultural and energy products, the latter potentially exacerbated by shortfalls in domestic electricity production. Inflation risks also come from demand pressures due to higher public-sector salaries and social transfers that were included in the 2025 budget, and a potential further increase in social benefits. Further labour market tightening through continued emigration pressures might generate additional upward pressures on inflation.

**The current account deficit widened in 2024 and is expected to remain relatively high at 8% of GDP.** The current account deficit rose to nearly 9% of GDP in 2024 from 7.5% in 2023. The increase was driven by a decline in the services trade and secondary income surpluses, which more than offset the slight improvement in the merchandise trade balance and the increase in the primary income surplus. The surplus in the trade of services fell by 1.2 pps. to 15.6% of GDP, mainly due to increased imports of travel services (tourism) following EU visa liberalisation as of January 2024. At the same time, the traditionally high merchandise trade deficit narrowed by 0.4 pps. to 47.1% of GDP, on the back of slightly increased exports and lower imports of goods, the latter reflecting lower import prices. Remittances decreased by 0.6 pps. to 13.2% of GDP, and they are forecast to grow annually by around 6% on average over the programme period. Large errors and omissions (2.5% of GDP) may reflect unrecorded services exports and remittances, so the actual current account deficit could be smaller than the official estimates. The ERP expects the current account deficit to widen to 9.3% of GDP in 2025. This appears plausible, given the expected increase in imports, reflecting rising domestic demand and higher investment. In 2026-2027 the deficit is projected to fall to around 7% of GDP on average, in line with the expected higher external demand and the resulting improvement in the overall trade deficit.

**Graphs: external competitiveness and current account**




**Foreign direct investment is set to continue financing a large part of the current account deficit.** Net foreign direct investment inflows fell to an estimated 6.4% of GDP in 2024 compared to 6.8% in 2023, still covering most (72%) of the current account deficit. The bulk of inflows was directed to non-tradeable activities, with real estate and financial and insurance services accounting for 72% and 16% of all foreign direct investment inflows respectively (in January-November 2024), doing little to improve export capacity. The ERP projects that net foreign direct investment inflows will be roughly stable at EUR 0.7 billion over the programme period. Due to the projected increase in nominal GDP, these inflows are therefore expected to gradually decrease from 6% of GDP in 2025 to 5.2% in 2027, which is not sufficient to fully cover the current account deficit. Kosovo's net international investment position is estimated to have deteriorated to -20.5% of GDP in 2024, compared to -18.5% in 2023. Almost 70% of gross liabilities consist of foreign direct investment, which is considered a more stable source of financing, limiting external vulnerabilities.

*Table 2:*

**Kosovo - financial sector indicators**

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|
| **Total assets of the banking system (**EUR million) | 5 365 | 5 960 | 6 762 | 7 542 | 8 556 |
| **Foreign ownership of banking system** (%) | 86.5 | 85.5 | 84.9 | 84.3 | 83.6 |
| **Credit growth** (%, average) | 7.7 | 11.2 | 17.4 | 14.1 | 14.3 |
| **Deposit growth** (%, average) | 12.2 | 13.8 | 10.8 | 13.9 | 10.0 |
| **Loan-to-deposit ratio** (end of period) | 74.5 | 76.5 | 78.3 | 80.2 | 84.0 |
| **Financial soundness indicators** (%, end of period) | | | | | |
| **- non-performing loans to total loans** | 2.7 | 2.1 | 2.0 | 2.0 | 1.9 |
| **- regulatory capital to risk-weighted assets** | 16.5 | 15.3 | 14.8 | 15.8 | 16.2 |
| **- liquid assets to total assets** | 39.8 | 37.4 | 36.5 | 34.7 | 32.6 |
| **- return on equity** | 14.0 | 17.6 | 20.6 | 19.7 | 19.9 |
| **- foreign exchange loans to total loans** | 0.1 | 0.1 | 0.3 | 0.2 | 1.2 |

*Source: Central Bank of Kosovo.*

**The predominantly foreign-owned banking sector remained resilient, but strong credit growth calls for a continued strengthening of banking supervision.** Annual average bank lending growth slightly accelerated to 14.3% in 2024, from 14.1% in 2023, mainly on the back of a faster pace of credit growth to households, mostly for consumption purposes. The growth of bank deposits slowed to an average of 10% in 2024 from nearly 14% in 2023. Financial soundness indicators remained satisfactory, e.g. the loan-to-deposit ratio and non-performing loan (NPL) ratio[(4)] stood at 84% and 1.9%, respectively at end-2024. Bank profitability has slightly improved, with the average return-on-equity ratio reaching 19.9% in 2024 from 19.7% in 2023. The ERP does not provide quantified forecasts for the financial sector but its underlying assumption is of a moderate increase in NPLs during 2025, necessitating increased provisioning for credit risks. As mortgage lending to households recovered strongly in 2024, it would also appear appropriate to strengthen surveillance of private-sector indebtedness and the housing market, including by compiling residential sector statistics using bank loan data.

In the context of lower interest rates and strong credit growth there is a need to strengthen supervisory capacity. The Central Bank of Kosovo (CBK) has recently conducted an organisational structure review in line with its new Strategic Plan while recruitment efforts continued throughout the year. It also continued to enhance risk-based supervision in line with best international and European practices. Among other initiatives, the CBK is advancing the framework for borrower-based measures using credit registry data. With additional information, such as updated revenue information of the borrower or the loan destinations of uncollateralised loans, the CBK will be able to analyse the credit risk better. To this end, a revision of the Credit Registry Regulation to enhance both the coverage and the reporting system would be beneficial. Rapid credit growth also requires improved financial crisis preparedness. To this end, and given Kosovo's euroisation, a review of the Emergency

4 The stable NPL ratio was also supported by the denominator effect, i.e. continued credit growth.

Liquidity Assistance (ELA) arrangement would prove useful as it has remained unchanged in size since its introduction in 2012.

## 3. PUBLIC FINANCE

**Robust tax revenue growth and surging capital and social spending resulted in the budget remaining close to balance in 2024.** The headline budget deficit stood at 0.3% of GDP in 2024, which corresponds to a surplus of 0.5% of GDP under the fiscal rule's definition [5]. The headline deficit was marginally higher than in 2023 (0.2% of GDP), but it significantly undershot the target of 2.7% set in the 2024 budget due to revenue overperformance. Compared to 2023, a robust increase in public expenditure (8.6% year-on-year) slightly outpaced the buoyant rise (8.2%) in government revenue. The spending increase was driven by capital spending (up by 15.4%), even though it only reached 75% of the budget allocation, reflecting overoptimistic targets and remaining weaknesses in implementation capacity. The execution of current expenditure (+6.6% y-o-y) was in line with the budget plan. Wages and allowances rose strongly, by nearly 10% y-o-y due to the implementation of the law on public-sector wages and the increase in the amount paid from court rulings[6], while spending on goods and services grew by 7.4%. Social transfers surged by almost 18% y-o-y, reflecting government measures ahead of the 9 February 2025 parliamentary elections, including higher child benefits and pensions. However, subsidies decreased substantially by nearly 20%. Public revenue grew strongly in 2024, surpassing the planned increase of 5%, partly due to improved tax compliance and some formalisation gains[7]. Tax revenue increased by 10.3% y-o-y, with direct and indirect tax[8] income growing by 9% and 10.6%, respectively. Grants fell by almost 88% y-o-y, reflecting base effects due to the EUR 67.5 million (0.7% of GDP) energy-crisis-related budget support from the EU in 2023. Government deposits have fallen to 2.1% of GDP from 2.4% in 2023, reflecting higher nominal GDP, lower external budget support financing and net negative domestic debt issuance.

**The ERP objective for 2025-2027 is to significantly increase the public investment ratio while complying with the fiscal deficit rule.** Over the programme period, public revenue is set to decline by 0.6 pps. to 29.3% of GDP by 2027, mainly due to a decrease in non-tax revenue[9], while tax revenue is set to fall marginally in 2025 before stabilising at around 27% of GDP in the following two years. Public expenditure is projected to increase by 0.8 pps.

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5 The fiscal rule places a cap on the fiscal deficit of 2% of forecast GDP, excluding capital projects financed by privatisation proceeds and donors ('investment clause'). This exemption for donor-financed investments can be invoked until 2026, provided the public debt ratio remains below 30% of GDP. A further rule stipulates that the increase in the public wage bill cannot exceed nominal GDP growth. Government deposits used as fiscal buffers are legally required to stay at 4.5% of GDP as long as the government uses privatisation proceeds. The debt rule requires that public and publicly guaranteed debt cannot exceed 40% of GDP.

6 The law came into force in February 2023 setting the value of the wage coefficient at EUR 105 for 2023 and EUR 110 for 2024. Most of the rulings concerned unbudgeted allowances that teachers, doctors, and other public employees obtained through collective agreements.

7 Administrative reforms implemented by the Tax Administration of Kosovo (TAK) have brought some formalisation gains.

8 This concerns revenue from VAT, customs duties and excises.

9 The decrease is mainly due to the non-inclusion of revenues from the agreement between Kosovo and Denmark on leasing of prisons as well as of revenues from financial investments in 2026-2027.

over the ERP period to 31.1% of GDP in 2027, mainly due to the planned very sizeable (2.1 pps.) upfront increase in capital spending in 2025, bringing public investment to above 8% of GDP, at which level it will remain over the programme period. Current spending is set to decrease gradually by 1.1 pps. to 22.3% of GDP in 2027, mainly driven by lower spending on transfers and subsidies, which is not further substantiated in the programme, and to a smaller extent on public wages. After a large increase in 2025, the headline deficit and the deficit as per the fiscal rule definition are set to remain unchanged in 2026, at 2.8% and 2% of GDP respectively, before falling to 1.8% and 1.7% of GDP, respectively, in 2027.

*Table 3:*

**Kosovo - composition of the budgetary adjustment (% of GDP)**

| | 2023 | 2024 | 2025 | 2026 | 2027 | Change: 2024-27 |
|---|---|---|---|---|---|---|
| **Revenues** | 29.5 | 29.9 | 29.7 | 29.6 | 29.3 | -0.6 |
| - Taxes and social security contributions | 26.0 | 27.0 | 26.8 | 27.0 | 26.9 | -0.1 |
| - Other (residual) | 3.4 | 3.0 | 2.9 | 2.6 | 2.5 | -0.5 |
| **Expenditure** | 29.7 | 30.3 | 32.5 | 32.4 | 31.1 | 0.8 |
| - Primary expenditure | 29.3 | 29.9 | 32.1 | 32.0 | 30.7 | 0.8 |
| *of which:* | | | | | | |
| Gross fixed capital formation | 5.8 | 6.3 | 8.4 | 8.5 | 8.2 | 1.9 |
| Consumption | 12.3 | 12.6 | 13.1 | 12.7 | 12.2 | -0.4 |
| Transfers & subsidies | 11.1 | 10.8 | 10.5 | 10.7 | 10.1 | -0.7 |
| Other (residual) | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | -0.1 |
| - Interest payments | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.0 |
| **Budget balance** | -0.2 | -0.4 | -2.8 | -2.8 | -1.8 | -1.4 |
| - Cyclically adjusted | -0.7 | -0.8 | -2.9 | -2.9 | -2.3 | -1.5 |
| **Primary balance** | 0.2 | 0.1 | -2.4 | -2.4 | -1.3 | -1.4 |
| - Cyclically adjusted | -0.2 | -0.3 | -2.4 | -2.4 | -1.8 | -1.5 |
| **Gross debt level** | 17.5 | 16.5 | 21.1 | 23.0 | 24.0 | 7.5 |

*Sources: Economic Reform Programme (ERP) 2025, Commission calculations.*

**The 2025 budget plans a significant increase in the headline deficit, primarily driven by a front-loaded surge in capital spending.** The 2025 budget projects public revenue to decrease by 0.2 pps. to 29.7% of GDP compared to the 2024 outturn due to a similar drop in the tax revenue ratio. In nominal terms, tax revenue is expected to increase robustly by 7% y-o-y, supported by higher economic activity, improved tax compliance and a further reduction in the informal economy. Grants are set to decrease by 25% year-on-year, partly due to the EUR 7.5 million (0.1% of GDP) energy-sector-related budget support from the EU in 2024[10]. The assumed growth in tax revenue looks plausible, due to authorities' continued efforts to further strengthen tax compliance and tackle the informal sector[11]. Total expenditure is

[10] Grants from the pre-financing component of the Reform Agenda have not been taken into account when preparing the 2025 budget.

[11] According to the latest IMF Article IV Report of December 2024, 'Tax administration improvements, which drove recent increases in collections, reflect a focus on modern compliance risk management (with

planned to increase to 32.5% of GDP from 30.3% in 2024, mainly due to a 2.1 pps. rise in public investment spending. Compared to the 2024 outturn, capital spending is set to increase by almost 44%. Such a significant increase looks overly optimistic, given the previous track record of implementing capital spending and would require a comprehensive overhaul of the institutional framework for investment planning and management. The IMF expects capital spending in 2025 to remain unchanged compared to 2024, at 6.7% of GDP. Current expenditure is set to rise by 0.2 pps. to 23.6% of GDP in 2025, largely driven by higher spending on goods and services related to the February parliamentary elections and the upcoming municipal ones in September. The wage bill is set to grow by 0.1 pps. to 8.3% of GDP, reflecting last October's government announcement to increase public wages in two steps (in January and July). Notwithstanding the full-year impact of recent increases in pensions and child allowances, subsidies and transfers are projected to fall by 0.3 pps. to 10.5% of GDP. Debt interest payments are set to remain unchanged at 0.4% of GDP in 2025. The 2025 budget includes a 1% of GDP allocation for contingencies, of which 0.5% of GDP is a blanket allocation. This is slightly lower than in the 2024 budget (0.7% of GDP), but such blanket allocations undermine fiscal transparency. The headline deficit is forecast to rise significantly to 2.8% of GDP in 2025, which would keep the deficit as measured according to the fiscal rule's definition at the prescribed ceiling of 2% of GDP. Government cash deposits are planned to increase to 3.1% of GDP from 2.1% in 2024, which is still in line with the prescription of the fiscal rule[12]. On the revenue side, the projected increase in tax revenue of 7% in 2025 looks plausible, with revenue gains expected to come from further reduction in informality and improved tax compliance. However, the ERP does not outline any reforms to widen the tax base.

**General government debt is projected to remain low, while weaknesses linked to a narrow investor base and a lack of market access remain.** On the back of high nominal GDP growth and a marginal primary surplus, the debt-to-GDP ratio decreased by 1 pp. to 16.5% in 2024. This is well below the 2024 ERP projection of 18.8% and the fiscal rule ceiling of 40%. However, the figures do not factor in the liability from COVID-19-related tax-free withdrawals of 10% of pension savings from the Kosovo Pension Saving Trust (KPST), which the government started reimbursing in 2023.[(13)] Domestic debt, which is held by a narrow investor base, decreased marginally by 0.8% in 2024. The share of domestic debt stock held by the KPST, which is the largest investor, fell by 1 pp. to 45%. The KPST still has room to buy new bond issuances in the coming years, but it is approaching the legal limit[14]. The shares held by commercial banks and the Central Bank of Kosovo remained unchanged, compared to 2023 at 24% and 22%, respectively. Foreign debt rose by 12.1% in 2024 and consists of concessional financing from international financial institutions, such as the IMF, the World Bank, the European Investment Bank and the European Bank for Reconstruction

legislative changes), digital transformation, restructuring of the debt-collection function, strengthening of audit and dispute-resolution functions, and implementing a robust performance-assessment system.'.

12 The fiscal rule stipulates that Government deposits used as fiscal buffers are legally required to stay at 4.5% of GDP as long as the government uses privatisation proceeds. As no privatisation proceeds are planned the fiscal rule is not breached if fiscal buffers are below 4.5% of GDP.

13 The IMF estimates the liability to KPST to be 1.8% of 2020 GDP.

14 Government securities should not exceed 30% of KPST assets.

and Development. The ERP assumes a significant increase of 4.6 pps. in the public debt ratio in 2025 to 21.1% of GDP and a continued gradual drift upwards to 24% of GDP in 2027. It projects government deposits to hover around 3.2% of GDP in 2025-2027, notably higher than the level expected in the previous year's ERP, which may provide sufficient capacity to absorb potential new shocks. In October 2024, Fitch Ratings reaffirmed the 'BB-' with a stable outlook sovereign credit rating that Kosovo had obtained for the first time in April 2024. This could help Kosovo access international markets in the near future.

**Kosovo**

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

| | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|---|---|---|---|---|
| Gross debt ratio [1] | 17.5 | 16.5 | 21.1 | 23.0 | 24.0 |
| Change in the ratio | -2.6 | -1.0 | 4.6 | 1.9 | 0.9 |
| Contributions [2]: | | | | | |
| **1. Primary balance** | **-0.2** | **-0.1** | **2.4** | **2.4** | **1.3** |
| **2. 'Snowball effect'** | **-1.2** | **-0.6** | **-0.7** | **-1.1** | **-1.3** |
| *Of which:* | | | | | |
| Interest expenditure | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 |
| Growth effect | -0.7 | -0.7 | -0.9 | -1.3 | -1.4 |
| Inflation effect | -0.8 | -0.3 | -0.3 | -0.3 | -0.3 |
| **3. Stock-flow adjustment** | **-1.2** | **-0.3** | **2.9** | **0.6** | **0.9** |

[1] End of period.

[2] The 'snowball effect' captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).
The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets, and valuation and other effects.

*Source: Economic Reform Programme (ERP) 2025, Commission calculations.*

### Debt dynamics

The primary balance is projected to turn negative in 2025 and stay negative over 2026/27, contributing significantly to the projected increase in the public debt ratio. This is set to be partly offset by the impact of robust economic growth and, to a more limited extent, inflation. Interest expenditure is forecast to stay low and roughly stable at 0.5% of GDP in 2025-2027. Overall, the snowball effect will only partly compensate for the impact of the primary balance on the debt ratio. Moreover, a strong positive contribution to the debt-to-GDP ratio is expected to come from stock-flow adjustments in 2025, followed by more modest ones in 20 26 and 2027, although their origins are not explained in the ERP.

**The fiscal scenario is subject to significant fiscal risks and uncertainties.** Fiscal projections are likely to underestimate current spending, while the assumed large increase in capital spending in 2025 appears unrealistic if the past track record is taken into account. On the spending side, the decrease in the allocation for transfers and subsidies as a percentage of GDP seems rather benign. There is a risk that they might increase more than the targeted 1.4% compared to the 2024 outcome as existing schemes might prove more costly than expected. Despite the law decoupling war veterans' pensions from the minimum wage, which came into force in August 2024, there is a risk of once again breaching the legal cap of 0.7% of GDP in the absence of a reclassification of beneficiaries[15]. Furthermore, in the context of the municipal pre-election period there may be pressure to roll-out new initiatives of (untargeted) social transfers for which no amounts are earmarked in the 2025 budget. The planned increase in the wage bill also looks optimistic given the previous track record in this area[16]. The 2025 budget includes an allocation of only EUR 3 million for reimbursing the

[15] There was a slight breach of the legal ceiling of 0.7% of GDP in 2024 as actual expenditure for this pension scheme amounted to almost 0.8% of GDP.

[16] The wage bill rule was slightly breached in 2024 as the increase of nearly 10% in the public wage bill was higher than the nominal GDP growth (8.8%) in 2023.

COVID-19-related 10% withdrawal of pension savings from the Kosovo Pension Saving Trust (KPST)[17], thereby requiring higher allocations in the following years' budgets to fully repay this liability. Overly optimistic GDP growth projections are also a downside risk for revenue.

**Weak governance and poor financial oversight and accountability of publicly owned enterprises (POEs) represent additional fiscal risks,** which could require (further) large subsidies[18] from the budget. Despite recent improvements in monitoring the fiscal risks emanating from POEs' operation and the approval of their annual performance report for 2022, the law that regulates their corporate governance is not aligned with recognised international standards. In mid-December 2023, the Assembly adopted a law for the creation of a sovereign fund managing state assets which, once established, is set to play a key role in improving the management and financial performance of POEs. However, the law is being reviewed by the Constitutional Court, following a request by the opposition.

**Sensitivity analysis**

The ERP analyses the sensitivity of the debt-to-GDP ratio to three specific shocks:

1) A slowdown in GDP growth of 1 percentage point would bring the debt-to-GDP ratio to 33.4% by the end of 2037 instead of 29.6% in the baseline scenario, if the deficit rule is followed in 2028-2037.

2) If, due to higher spending, the primary balance deteriorates by 1 percentage point of GDP in 2028-2037 and the deficit rule is not followed, debt would increase to 45.4% of GDP by the end of 2037, i.e. 15.8 percentage points higher than in the baseline scenario.

3) A 1 percentage point increase in interest rates on loans combined with no compliance with the deficit rule would bring the debt-to-GDP ratio to 32.4% by the end of 2037, i.e. 2.8 percentage points higher than in the baseline scenario.

The sensitivity analysis underscores the importance of complying with the 2% deficit rule, which acts as a debt stabiliser.

**Public spending efficiency suffers from persistent issues such as inappropriate targeting and lack of transparency of social transfers.** A large share of specific category-based social transfers, including war-related pensions that are non-contributory and financed from the budget, do not directly target poverty reduction. Fiscal transfers to mitigate the increased cost of living such as one-off increases in child allowances are also not targeted[19].

**Enhancing public investment management is key to fostering a more growth-oriented budget structure.** According to IMF estimates, Kosovo has lower relative capital stock levels

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17 The framework provides for five annual instalments of EUR 20 million each as of 2023. Only EUR 1.9 million were disbursed in 2024 and EUR 5 million in 2023.

18 The MoFLT cannot provide the exact amount of subsidies and capital transfers to POEs, as it is not possible to generate consolidated reports in the Kosovo Financial Management Information System (KFMIS) that capture all financial transactions to POEs, thereby posing a fiscal risk and undermining fiscal transparency.

19 The child benefits are not laid down in the respective legislation yet (apart from the Law on budget appropriations).

and a lower growth rate in its real public capital stock, compared to peer countries[20]. Weaknesses in the planning phase of public investment projects remain a significant challenge, as many of them do not undergo a proper appraisal and selection procedure as outlined in the administrative instructions on project selection and the public investment programme manual. In particular, a critical shortcoming in the planning phase is the lack of robust feasibility and pre-feasibility studies. Furthermore, existing administrative guidelines do not incorporate climate considerations in the appraisal and selection process for capital projects. The latter are therefore not ready for implementation when approved. Weak project oversight hampers corrective action when necessary. On a positive note, steps have been taken to improve public investment execution by introducing comprehensive project cost budgeting and prioritising smaller, rapidly executable projects over larger, complex initiatives requiring extensive coordination with development partners. To address shortcomings in public investment management, Kosovo could establish the linkages between the e-procurement system and the Kosovo Financial Management Information System (KFMIS), as recommended in the IMF's updated Public Investment Management Assessment.

**Ongoing tax policy reforms are crucial to strengthening Kosovo's revenue base and addressing fiscal challenges.** Kosovo's tax system is undermined by numerous exemptions, preferential rates, and special regimes that erode the tax base. To address this, it is necessary to approve and publish the available comprehensive review of tax expenditures, quantifying the revenue losses caused by these practices. Moreover, to reduce loopholes and exemptions, the government is preparing amendments to the personal income tax, corporate income tax, and value added tax laws. These tax policy reforms are particularly important for raising revenue to offset the anticipated decline in customs revenue, following the implementation of the free trade agreement with Türkiye, the Stabilisation and Association Agreement (SAA) with the EU, and the free trade agreement that was signed with the European Free Trade Association (EFTA)[21] in January 2025.

**Kosovo's fiscal rules are the main anchor for fiscal policy and safeguard high out-of-budget capital spending.** The 2025 budget appropriately aims to keep the deficit (according to the fiscal rule's definition) at the prescribed ceiling of 2% of GDP. The deficit is expected to remain unchanged in 2026, before decreasing to 1.7% of GDP in 2027. Nevertheless, the enforcement of the fiscal framework suffers from the unfinished reclassification of war veteran pension beneficiaries and continuously expanding social commitments. According to the fiscal rule definition, the exemption from the 2% deficit ceiling of capital projects financed by privatisation proceeds and donors can be invoked up until 2026, provided that public debt remains below the prescribed ceiling of 30% of GDP (which is expected to be the case). Despite the planned increases in public-sector salaries, the wage bill is expected to grow by 8.7% in 2025, which is lower than the nominal GDP growth in 2023, thus the wage bill rule will be respected. The proper functioning of Kosovo's fiscal framework is also conditional on the quality of macro-financial statistics, which require substantial further improvement.

## 4. MAIN MACRO-RELEVANT STRUCTURAL CHALLENGES

**The Commission approved the Reform Agenda of Kosovo in October 2024.** In its Reform Agenda, Kosovo commits to socio-economic and fundamental reforms it will undertake to

[20] Albania, Bosnia and Herzegovina, Croatia, Montenegro, North Macedonia, Serbia, and Slovenia.

[21] EFTA comprises Iceland, Liechtenstein, Norway, and Switzerland.

boost growth and convergence with the EU under the Growth Plan over the 2024 – 2027 period. Subject to the implementation of these reforms, under the Reform and Growth Facility[22], the allocation for Kosovo amounts to EUR 882.6 million with EUR 253.3 million planned in grants and EUR 629.3 million in concessional loans. Out of the total amount of support, EUR 410.6 million is to be allocated in the form of budget support, while the remaining EUR 472 million will be allocated for the financing of infrastructure projects and implemented through the Western Balkan Investment Framework (WBIF). Kosovo's Reform Agenda addresses structural bottlenecks identified in the 2024-2026 ERP as well as in the joint conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye in May 2023.

**The corporate structure is dominated by service-driven, family-owned businesses with limited global integration.** Kosovo's corporate landscape consists mainly of small and micro family-owned businesses, predominantly operating in the services sector. This sector plays a major role in the economy, contributing 46% of gross value added in 2023 and accounting for 73% of employment. While travel services – largely driven by the diaspora – lead the sector, the information and communication technology (ICT) industry has also been expanding lately. Industry represents 18% of gross value added in 2023, but the country's manufacturing base remains narrow, and mining has a limited economic footprint due to decades of under-investment. Kosovo's participation in global value chains is weak, with exports primarily consisting of low-value-added, unsophisticated goods. Kosovo's businesses experience difficulties in accessing the EU market partly due to trade barriers[23] and weak institutions. The Reform Agenda aims at supporting the creation and scaling-up of start-ups and micro, small, and medium-sized enterprises (MSMEs) specialised in ICT and green and circular economies by establishing an Innovation Fund and business incubators.

**A weak business environment remains a key structural challenge.** An unpredictable regulatory and institutional environment, a high degree of informality, corruption as well as a weak rule of law hamper private-sector investment. A high administrative burden for businesses and citizens, coupled with inefficiencies in contract enforcement and dispute resolution, further impede economic development despite government efforts to improve conditions. Small and medium-sized enterprises (SMEs), often face difficulties in securing funding to expand their operations. The Commercial Court, which is expected to enhance judicial efficiency in settling commercial disputes, still grapples with a significant backlog of cases. Meanwhile, the new law on sustainable investment, which came into force in August 2024, aims to provide a comprehensive legal framework for the protection, promotion, and encouragement of sustainable investments in Kosovo. The Reform Agenda includes measures aimed at implementing bankruptcy legislation through alignment with the EU *acquis*, enhancing access to finance, payment system integration, and financial inclusion.

**Kosovo's unreliable energy supply hampers economic competitiveness and foreign investment.** Energy supply in Kosovo remains insufficient and unstable. While energy demand has been growing rapidly, this poses a major challenge to productivity and competitiveness. The lack of energy security imposes significant costs on businesses, deters high-quality foreign direct investment, and strains public finances. Kosovo also suffers from major technical and commercial losses in the distribution and transmission grids due to poor infrastructure (more than 20% in total). Currently, around 88% of the country's electricity is

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22 https://eur-lex.europa.eu/eli/reg/2024/1449/oj/eng

23 Kosovo lacks preferential access under the Stabilization and Association Agreement (SAA) unlike other Central European Free Trade Agreement (CEFTA) countries.

generated by two ageing, unreliable, and highly polluting lignite-fired thermal power plants. Efforts are made to diversify the energy mix. In March 2024, authorities awarded the first 100 MW solar project, securing EUR 70 million in private investment. Additionally, Kosovo has launched its first tender for 100 MW of wind energy, with bids received in late February. The green transition-component of the Reform Agenda will contribute to transposition and implementation of essential EU legislation and directives, such as the Clean Energy Package, the Energy Efficiency Directive and the Energy Performance in Buildings Directive. The Reform Agenda sets ambitious targets with regard to decarbonisation and renewables deployment.

**Kosovo is leading in internet access, but digitalisation of public services and e-commerce remain underdeveloped.** According to the Organisation for Economic Co-operation and Development (OECD)[24] (2024), Kosovo is the leader in the Western Balkan region with 98.6% of households having some form of internet access in 2023, surpassing the EU average of 93.08%. However, fixed broadband adoption remains below the regional average due to infrastructure limitations, network unavailability in certain areas, affordability issues, and low demand. The e-commerce sector remains underdeveloped. According to the IMF (2024), 44% of individuals report that they do not know online banking platforms. Progress in public-sector digitalisation has been slow, with only 10% of all public services currently offered online, most of which are merely informational (OECD, 2024). The digital transformation part of Kosovo's Reform Agenda aims at ensuring user-friendly digital public service delivery, expanding the offer of public services on the e-Kosova platform, developing the e-signature and deploying the Digital Identity Wallet, establishing a secure, resilient and sustainable digital infrastructure as well as ensuring the future development of a comprehensive framework for cyber resilience.

**Despite some progress, the labour market situation remains challenging while the education system is not adequately aligned with labour market needs.** Only around 41% of the working-age population was active in 2023, while - despite the notable decline - the unemployment rate was still high (10.9%). The share of young people (aged 15-24) not in employment, education or training (NEET) stood at 33.4%, the highest in the Western Balkans region. An increasing challenge is emigration. According to the World Bank (2024) around one third of the population lives abroad as more educated and young people are seeking employment there. There are also significant gender differences in the labour market as nearly 76% of working-age women are economically inactive while those who are economically active are much less likely than men to be employed. Despite some educational reforms, Kosovo ranked 81st and last in the 2022 cycle of the OECD's Programme for International Student Assessment (PISA) while unemployment among tertiary education graduates is still high, pointing to the inadequate quality and relevance of education. The workforce is not equipped with the skills needed for modern economic activities. Despite some progress, including partnerships between vocational education and training (VET) schools and employers and the introduction of dual education in several profiles, these initiatives remain limited. The Reform Agenda covers five reforms encompassing a digitalised education system, increased enrolment in and quality of early childhood education, enhanced quality of education and teaching, increased labour market participation of women, young people and vulnerable groups, as well as the alignment of education with labour market needs.

[24] OECD (2024), *Western Balkans Competitiveness Outlook 2024*.

## 5. Consistency of the Reform Agenda with the ERP's macro-fiscal framework

**The ERP includes a first attempt to estimate the economic impact of selected reform measures under the Reform Agenda.** The chosen policy areas concern: (i) energy/green transition and (ii) private-sector development and business environment. The analysis contains estimates on the impact of reforms on growth, but these were not taken into account in the ERP's macro-fiscal framework. Fiscal impacts of the selected reforms are not yet included in the analysis.

**The selection of reforms for the impact assessment was based on two criteria.** First, the selected reforms should have a direct impact on economic growth, in particular on investment, employment and/or the business environment. Second, sufficient data and information were available for each one of the chosen reforms to ensure credible estimates of their economic impact.

Specifically, the following three reforms were subject to an economic impact assessment:

- Development of transparent and competitive procedures for the deployment of renewable energy. The planned investment in renewable energy projects, which is in line with the targets set in Kosovo's National Energy and Climate Plan (NECP), is projected to have a cumulative effect of 2.5% and 4 800 jobs on GDP growth and employment respectively, over the medium term. These estimates seem plausible as they are also supported by the results of an alternative methodology, which is based on a relevant study[25].
- Implementation of the Energy Efficiency Directive and the Energy Performance in Buildings Directive. The reform aims at a 3% additional annual renovation of public buildings and a renovation of 0.5 million $m^2$ of residential buildings. It is expected to increase GDP by 0.7% and create some 930 jobs in 2025-2027.
- Financial support for start-ups and micro, small and medium-sized enterprises (MSMEs). The measure aims to foster the creation and scaling-up of MSMEs in the ICT, green and circular economy sectors. It is projected to increase GDP by 0.2% cumulatively in the medium term, while there is no calculated estimate of the impact on employment. This estimate is comparable with the results of a study[26] about the impact of an increase in R&D expenditure on GDP growth.

**An assessment of the fiscal impact of implementing the Reform Agenda would likely have added clarity to the government's medium-term fiscal plans.** The revenue forecast of the 2025 budget does not contain the pre-financing amount (EUR 17.7 million) as well as the payments linked to individual reforms. The programme could have included the projected expenditure linked to the implementation of the measures, including information on whether respective projects are included in the capital spending projected for 2025. Moreover, the Reform Agenda contains a number of measures from the area of Public Financial Management that would have been suited to be assessed with a view to their fiscal impact, notably measures related to the improvement of public investment management.

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[25] Nicoletta Batini, Mario Di Serio, Matteo Fragetta, Giovanni Melina, Anthony Waldron, Building back better: How big are green spending multipliers? Ecological Economics,Volume 193, 2022.

[26] Guellec, D., & van Pottelsberghe de la Potterie, B. (2004). From R&D to Productivity Growth: Do the Institutional Settings and the Source of Funds of R&D Matter? Oxford Bulletin of Economics and Statistics, 66(3), 353-378.

## ANNEX 1: OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2024

*Every year since 2015, the Economic and Financial Dialogue between the EU and enlargement partners has adopted targeted policy guidance for all partners. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the guidance is evaluated by the Commission in the following year's ERP assessments.*

*The following table presents the Commission's assessment of the implementation of the 2024 policy guidance jointly adopted at the Economic and Financial Dialogue on 14 May 2024.*

| **Overall: Partial implementation (58.3%)**[27] | |
|---|---|
| **2024 policy guidance (PG)** | **Summary assessment** |
| **PG 1:**<br><br>Implement the foreseen shift in the 2024 budget spending structure from current to capital expenditure while ensuring compliance with the fiscal rules. | There was **partial implementation** of PG 1.<br><br>**1) Partial implementation:** In 2024, capital and current spending accounted for 20.7% and 77.3% of total expenditure respectively, compared to 19.5% and 78.8% in 2023. However, the shift towards capital spending is much less pronounced than planned in the budget (25.9% and 72.3% for capital and current spending, respectively). Robust revenue performance was outpaced by the strong increase in capital spending and the headline budget deficit rose marginally to 0.3% of GDP in 2024. This corresponds to a surplus of 0.5% of GDP under the fiscal rule definition. However, the increase of nearly 10% in the public wage bill in 2024 was higher than the nominal GDP growth (8.8%) in 2023, thus the wage bill rule was slightly breached. |
| Increase budgetary transparency by further reducing blanket allocations. | **2) Full implementation:** The 2025 budget includes a 1% of GDP allocation for contingencies, of which 0.5% of GDP is a blanket allocation. This compares to an allocation of 1.3% and 0.7% of GDP, for contingencies and blanket allocations, respectively in the 2024 budget. |
| Enhance the revenue side by reducing loopholes and exemptions through amendments to tax legislation, including personal income tax (PIT), corporate income tax (CIT) and value added tax (VAT). | **3) No implementation:** There was no progress in amending tax laws, including PIT, CIT and VAT to reduce loopholes and exemptions. |
| **PG 2:**<br><br>Undertake and publish a review of tax expenditure quantifying the size of the revenue | There was **partial implementation** of PG 2:<br><br>**1) Partial implementation:** The World Bank provided technical assistance, funded by the EU, to the tax policy unit in the Ministry of Finance, Labour and Transfers |

[27] For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

| | |
|---|---|
| forgone from all exemptions, preferential rates and special regimes. | (MoFLT) to carry out an assessment of the revenue forgone for 2022 from all tax exemptions, preferential rates and special regimes. The assessment is ready, but is yet to be endorsed and published by the MoFLT. In November 2024, the government published a report, summarising the main fiscal developments in 2023. The report provides a preliminary quantification of the size of revenues forgone due to some of the tax exemptions and reduced rates in 2023. |
| Improve the execution rate of capital spending including by establishing the linkages between the e-procurement and Kosovo Financial Management Information System (KFMIS) systems, following the recommendations made under the IMF's updated Public Investment Management Assessment. | **2) Partial implementation:** Despite the authorities' efforts, the under-execution of capital expenditure remains a challenge. The execution rate of capital investments increased only to 75% in 2024 from 68% in 2023, but the year-on-year increase in public capital spending was robust at 15.4%. The improvement is partly due to the implementation of measures to boost the execution of public investment such as the incorporation of expropriation costs directly into the project envelope and the prioritisation of small projects that require fewer procedures and less coordination with stakeholders. The MoFLT and the Public Procurement Regulatory Commission (PPRC) signed a Memorandum of Understanding and agreed on a roadmap to establish the linkages between the e-procurement and Kosovo Financial Management Information System (KFMIS) systems. However, the work on linking the two systems has not been completed yet. |
| Improve financial oversight and accountability of publicly owned enterprises (POEs) by approving and publishing their annual performance report; adopt amendments to the POEs' Law to improve their corporate governance. | **3) Limited implementation:** The annual POEs performance report for 2022 has been approved by the Assembly and published on the Ministry of Economy's website in Albanian only. The annual performance report for 2023 has not been finalised yet. During the reporting period, the Ministry of Finance continued to include the fiscal risk analysis for the main central POEs in the medium-term expenditure framework (MTEF), annual budget and the ERP. A stand-alone annual fiscal risk analysis was also published in October 2024. The fiscal risk analysis includes the POEs overseen by the Ministry of Economy as well as the Kosovo Electricity, Transmission, Market and System Operator (KOSTT), which is overseen by the Assembly. However, the analysis is limited to high-risk POEs, excluding other companies. A quarterly report on the financial situation of POEs is available on the Ministry of Finance's website, with better data quality. The law on the establishment of a sovereign fund was adopted by the Assembly in mid-December 2023, but it is being reviewed by the Constitutional Court, following a request by the opposition. The sovereign fund is expected to take over six POEs to strengthen their management and attract private capital. The fund will operate as an autonomous public institution under the supervision of the Assembly. There were no developments in amending the law on POEs with the aim of aligning their corporate governance with recognised international standards. |

| **PG 3:** | There was **substantial implementation** of PG 3: |
| --- | --- |
| Continue to thoroughly assess price developments and possible second-round effects and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. | **1) Full implementation:** The central bank carefully monitored price dynamics. Plans to further enhance the monitoring of inflation expectations are welcome. The central bank recently announced the activation of additional macroprudential tools (countercyclical capital buffer and a capital surcharge for other systemically important banks) against the background of rapid credit growth. |
| Continue efforts to ensure that core areas of the central bank are adequately staffed, particularly by finding ways to attract and retain skilled staff. | **2) Substantial implementation:** The central bank has recently conducted an organisational structure review in line with its new Strategic Plan. Recruitment efforts continued throughout the year, supported by some transfers to core areas. In addition, the compensation scheme was reviewed with the aim to increase incentives for attracting and retaining skilled staff in core areas. Efforts to enhance macroeconomic and stress-test modelling capacities and the analytical toolkit are ongoing and should be continued. |
| Enhance risk-based supervision in line with best international and European practices, including by further strengthening the monitoring toolkit and the reporting framework across the banking system and improving data collection to enable a comprehensive assessment of financial sector risks. | **3) Substantial implementation:** The authorities have continued to enhance the regulatory and supervisory framework. Recent initiatives for more frequent and detailed risk reporting by banks, enhancements of the credit registry, the development of a roadmap for adopting the Supervisory Review and Evaluation Process (SREP) and standardised regulatory and financial reporting standards are welcome. New laws on banks and payment services were finalised, aiming at further harmonisation with EU regulations. The development of a residential real estate index is ongoing, but further progress is needed to ensure effective surveillance of real estate risks. |

## ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted the economic reform programme (ERP) for 2025-2027 and submitted it to the Commission on 15 January 2025, within the set deadline. It is in line with the previously approved medium-term fiscal strategy and national development strategy. Some components of the ERP are lacking.

*Inter-ministerial coordination*

The ERP was centrally coordinated, with the Ministry of Finance, Labour and Transfers as the National Coordinator for Kosovo.

*Stakeholder consultation*

The section on institutional issues and stakeholder involvement, which explains the institutional process for the preparation and approval of the ERP as well as the public consultation, is missing. Annex 3, which should include information on the consultation process of external stakeholders, including the national parliament, local and regional government, social partners and civil society is also missing. Commission staff dealing with the ERP held consultations with representatives from think tanks, international financial institutions and donors.

*Macroeconomic framework*

The baseline scenario projects a robust acceleration of economic activity, which appears to be optimistic and requires a careful assessment. External assumptions are based on the projections made in the Commission's autumn forecast and the IMF's November 2024 World Economic Outlook. The ERP assessment of macro projections is based on ERP annex data. The programme provides an alternative 'low growth' scenario. This is useful to illustrate the likely impact on Kosovo's economy of some expected developments and risks, such as underspending in capital investment, lower foreign demand as well as a decline in remittances. The forecasts for the labour market and the financial sector are still lacking.

*Fiscal framework*

The fiscal projections are based on the adopted 2025 budget. For 2025, the ERP forecasts a marginally decreased public revenue-to-GDP ratio, whereas public expenditure is set to increase from the 2024 level, mainly due to a large surge in capital investment. Some of the 2024-2025 fiscal data are not consistent with the main text. The ERP provides a useful debt sustainability analysis with three negative shock scenarios.