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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
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Brussels, 12.4.2024
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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

KOSOVO*
(2024-2026)

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

Following some slowdown in economic activity in 2023, Kosovo's economic reform programme (ERP) expects GDP growth to pick up, mainly on the back of a robust increase in private and public investment. Annual output growth eased to a still buoyant 3.3% in 2023 from 4.3% in 2022, primarily due to the negative contribution of the external sector to GDP growth. The ERP baseline scenario projects an annual average GDP growth of 4.6% in 2024-2026, which appears to be overly optimistic. In particular, the strong increase in investment, a key growth driver in the ERP scenario, is likely to face constraints. These constraints are related to weak planning and insufficient implementation capacity for public investment projects and an uncertain economic environment for private investment. Major downside risks to this outlook stem from less dynamic growth in Kosovo's main EU (and non-EU) trading partners, tighter financing conditions, an acceleration of emigration flows following the EU visa liberalisation and lower-than-expected financial inflows from the diaspora.

After 3 years of substantial fiscal consolidation, the ERP expects a strong fiscal impulse in 2024, while ensuring compliance with the deficit rule in 2024-2026. Supported by strong revenue growth, the headline budget deficit fell to 0.2% of GDP in 2023, continuing the fiscal consolidation that started in 2021. Public capital spending increased substantially compared to 2022 but fell short of budget plans. The 2024 budget expects the headline deficit to rise to 2.7% of GDP, implying a strong fiscal stimulus mainly through an arguably very ambitious surge in public investment. However, the deficit (according to the fiscal rule definition) would not exceed the prescribed ceiling of 2% of GDP. The ERP expects the headline deficit to remain unchanged in 2025 and to fall to 1.9% of GDP in 2026. The public debt ratio is set to increase but remain low at slightly above 20% in 2026. However, the domestic public debt investor base remains narrow and Kosovo does not have access to international debt markets.

The main challenges facing Kosovo are the following:

- **The projected compliance with the deficit rule will serve as an anchor for fiscal policy but necessitates further reforms.** Implementing the planned large increase in capital spending while containing current expenditure remains key. Budgetary transparency and accountability could be improved by further reducing blanket allocations. Compliance with the 2% deficit ceiling over 2024-2026 could also be strengthened through policies to broaden the revenue base. A review of existing tax exemptions and preferential tax rates and the reduction of loopholes and exemptions through amendments to tax legislation would help mobilise revenues.

- **The significant increase planned in public investment requires comprehensive reforms to improve project planning and implementation.** Despite the authorities' continued efforts, Kosovo has made little progress in strengthening public investment management. Concrete steps, such as those recommended under the IMF's updated Public Investment Management Assessment (PIMA), could 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.

- **There are key structural obstacles to competitiveness and inclusive growth.** Structural bottlenecks, such as the high administrative burden for businesses and citizens, lack of proper resolution of commercial disputes and limited access to finance, continue to have a negative impact on fair competition in Kosovo. The large informal economy reduces budget revenues and hinders investment and business development, thereby constraining economic growth. The insufficient and unreliable supply of energy gives rise to significant costs for businesses while also putting pressure on public finance. The education system does not adequately equip students with the necessary skills required by the labour market. This market is characterised by low participation and high unemployment rates, in particular for women and young people. Weak labour-market outcomes contribute to continuously high emigration. These challenges are expected to be addressed through key structural reforms identified in Kosovo's reform agenda under the new 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 2023 has been partial. Strong public revenue growth substantially improved the budget balance. Compliance with the fiscal rule's deficit ceiling of 2% of GDP is expected to continue in 2024. The measures to mitigate the impact of the energy crisis on vulnerable households and businesses were mostly well-targeted. The law on public-sector salaries that came into force in February 2023, combined with a suitable value of the wage coefficient set by the government, ensured that the public wage bill did not exceed its legal ceiling. At the same time, actual spending on the war veterans' pension scheme slightly breached its prescribed legal ceiling. Tax revenue grew strongly, partly due to improved tax compliance and some formalisation gains, but there was little progress on reviewing tax exemptions. Financial oversight of POEs has improved but work to set up a fiscal oversight body has not advanced. Investment management also remains a major weakness. Kosovo finalised its first competitive auction for renewable energy projects, however the Law on Renewable Energy Sources is still pending adoption. Medium to long-term measures planned in the EU Energy Support Package are still to be implemented. Limited progress has been achieved in the area of electricity market liberalisation with the first day-ahead market auction for electricity delivery in Kosovo held by ALPEX[1]. Kosovo continued efforts to reduce informality by implementing planned activities, adopting a new action plan and relevant legislation. Necessary steps to complete the restructuring of SME and investment promotion agencies were taken, however their finalisation depends on a Constitutional Court decision. A roadmap for implementing key reforms to the education system was not developed. Kosovo has started implementing a dual education system. However the vocational education and training (VET) profiles remain largely unaligned with labour market needs. The restructuring of the public employment services is still underway, and further legislative steps and adequate budget allocation are needed to implement the Youth Guarantee and deliver relevant active labour market measures.

[1] Albanian Power Exchange – ALPEX (Bursa Shqiptare e Energjisë Elektrike) is a joint venture company owned by the Transmission System Operators of Albania (OST) and Kosovo (KOSTT).

2. ECONOMIC OUTLOOK AND RISKS

Kosovo's economic growth moderated in 2023 mainly due to weaker external demand. Real GDP growth softened to 3.3% in 2023[2], compared to 4.3%[3] in 2022. The key factor behind the deceleration was the negative contribution of net exports to growth, reflecting a notable slowdown in real exports growth. GDP growth was driven by an acceleration in private consumption growth on the back of rising real wages, higher bank lending and a slight increase in (net) remittances as a share of GDP. Also public consumption growth picked-up, largely due to higher public-sector wages. Growth in 2023 was also supported by a strong increase in public investment.

The ERP's baseline scenario projects a robust acceleration in real GDP growth in 2024-2025 before easing in 2026. Real GDP growth is set to pick-up to 4.6% in 2024 and further to 4.8% in 2025, before slowing to 4.4% in 2026. This acceleration is expected to be driven by a surge in public investment in 2024 (+23.1% year-on-year). Public investment looks set to benefit from: (i) improved implementation of future project appraisal and selection, (ii) implementation of the administrative instruction already approved in May 2023, requiring budget organisations to include expropriation costs as part of their project envelopes, and (iii) ensuring that technical evaluation and documentation on new externally-financed projects is finalised before signing the corresponding financial agreements. Private investment is also expected to increase by 8.7% y-o-y due to government support and the private sector's improving balance sheets. Private consumption is set to grow by 2.6% in 2024 and 3.4% on average, in 2025-2026, supported by higher bank lending and public-sector wages as well as lower inflation. Public consumption is projected to increase by 6.2% in 2024, followed by a more moderate pace, due to the planned increase in public sector salaries. Real exports are set to increase by 6.5% in 2024 and continue growing vigorously, by 7.2% on average in 2025-2026. In line with the envisaged robust investment increase, imports are expected to grow strongly, by 6.7% in 2024, before slowing to a pace of around 5% on average, in 2025-2026. As a result, the ERP projects net exports to provide negative contributions to GDP growth over the programme period; the largest in 2024 (-2.1 pps.) followed by a diminishing trend in 2025-2026. The programme expects the output gap to remain zero in 2024 and to turn positive thereafter, as real growth is projected to exceed the potential growth rate (estimated at 4.5%).

The ERP's baseline scenario appears overly optimistic and is beset by high uncertainty. GDP growth rates for 2024 and 2025 have been markedly revised downward from the previous year. Still, the growth path looks rather optimistic and much above the 4% average annual expansion projected by the IMF. In particular, the strong recovery in investment is likely to face constraints due to an uncertain economic environment for private investment, as well as persistent weaknesses in the planning, selection and management of public investment. The ERP itself notes that macro-fiscal risks remain high due to the linkages between Kosovo's economy and international partners through foreign trade and remittances inflows. Further increases in global energy and food prices - due to the escalation of Russia's full-scale war of aggression against Ukraine and geopolitical tensions, a tight monetary policy stance and the associated deceleration of economic activity in the euro area - will likely cause a further slowdown in inflows of remittances and will negatively affect external demand.

[2] Macroeconomic and fiscal estimates and forecasts covering the period 2023-26 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2023 have been taken from the relevant national sources (Kosovo Agency of Statistics (KAS) , Ministry of Finance, Labour and Transfers (MoFLT) and the Central Bank of Kosovo (CBK)).

[3] In December 2023, the Kosovo Agency of Statistics (KAS) revised the real GDP growth rate for 2022 downwards, to 4.3% (from 5.2%).

Significant domestic risks stem from outdated power generation capacity and high import costs, which may result in new power cuts and higher energy subsidies as well as a pick-up in emigration flows due to the EU visa liberalisation. The ERP's 'low growth' scenario results in an average annual growth rate of around 2.3% in 2024-2026, which appears more realistic than the baseline. The scenario's main assumptions are an under-execution of public investment, lower foreign demand, a decline in remittances and higher financing costs for the banking sector. The programme would benefit from the inclusion of a comparison between its medium-term growth projections and the potential output growth estimates.

Table 1:

Kosovo - macroeconomic developments

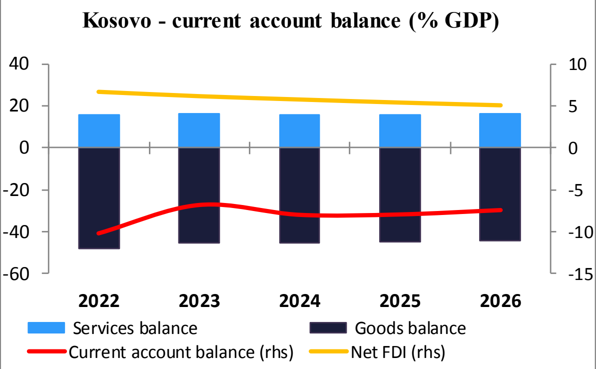
	2022	2023	2024	2025	2026
Real GDP (% change)	5.2	3.9	4.6	4.8	4.4
Contributions:					
- final domestic demand	2.8	1.0	6.2	5.4	4.1
- change in inventories	-0.3	0.3	0.5	0.5	0.5
- external balance of goods and services	2.8	2.6	-2.1	-1.1	-0.2
Employment (% change)	5.4	:	:	:	:
Unemployment rate (%)	12.6	:	:	:	:
GDP deflator (% change)	6.7	5.5	3.0	2.5	2.3
CPI inflation (%)	11.6	5.1	2.7	2.3	2.3
Current account balance (% of GDP)	-10.2	-6.8	-7.9	-7.9	-7.4
General government balance (% of GDP)	-0.5	-0.2	-2.7	-2.7	-1.9
Government gross debt (% of GDP)	20.0	17.3	18.8	20.4	21.4

Source: Economic Reform Programme (ERP) 2024.

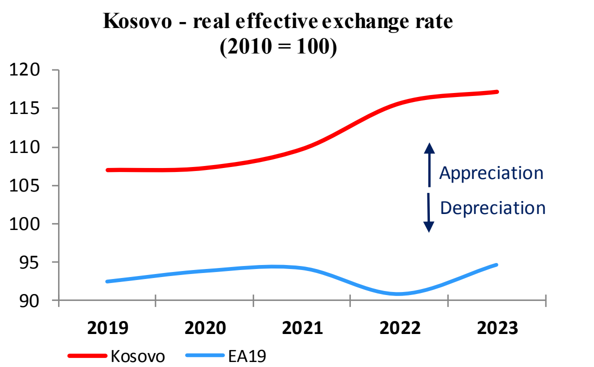
After a significant moderation in 2023, average inflation is expected to decline further in 2024-2026. Consumer price inflation decelerated substantially in the course of 2023, averaging 4.9% for the year as a whole (compared to 11.6% in 2022) and falling to as low as 2.2% in February 2024. The key driver of moderating inflation was lower commodity prices in international markets. The ERP expects average annual inflation to decrease further to 2.7% and 2.3% in 2024 and 2025-2026, respectively, on the back of the continued slowdown in global commodity prices. The ERP's inflation projection is more optimistic than the IMF forecast of an annual inflation rate of 3.5% in 2024. The programme rightly acknowledges the external risk of any intensification in the war in Ukraine and the fallout from this on commodity prices and external demand, as well as other geopolitical tensions (such as those around the Red Sea). 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 pensions that were included in the 2024 budget, and a potential increase in social benefits.

The current account deficit narrowed significantly in 2023, but the ERP projects it to widen over the programme period as domestic demand picks up. The continued rebound of services exports, coupled with the energy-balance-driven decline in the merchandise trade deficit, resulted in the current account deficit narrowing to 7.6% of GDP in 2023 from 10.3% in 2022. Diaspora tourism from Western Europe and exports of IT services fuelled a 1.4 pps. increase in the services surplus to 16.9% of GDP. At the same time, despite the moderate fall in goods exports, the traditionally high merchandise trade deficit narrowed by 0.6 pps. to 47.6% of GDP, mainly due to a notable decline in energy imports, reflecting falling energy prices globally. The primary income surplus widened to 1.9% of GDP in 2023 from 1.3% in 2022. Remittances increased by 0.2 pps. to 13.9% of GDP, and are forecast to follow historical trends in 2024-2026 with an annual average growth of 5%. Errors and omissions (2.9% 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 7.9% of GDP in 2024. This appears plausible, given the expected increase in imports, reflecting rising domestic demand and higher investment. A slight decrease in the deficit to 7.6% of GDP on average in 2025-2026 appears to be in line with the projected improvement in the overall trade deficit, mainly on the back of higher external demand.

Graphs: external competitiveness and current account



Source: Economic Reform Programme (ERP) 2024.



Source: Economic Reform Programme (ERP) 2024 and ECB.

Net foreign direct investment increased slightly in 2023 and covered some 90% of the current account deficit, on the back of financial inflows from the diaspora into real estate. Net foreign direct investment inflows grew to 6.8% of GDP in 2023 from 6.3% in 2022, covering most (89%) of the current account deficit. The bulk was directed to non-tradeable activities, with real estate and financial and insurance services accounting for 61% and 21% of all foreign direct investment inflows respectively, doing little to improve export capacity. The ERP projects that net foreign direct investment inflows will be roughly stable at EUR 0.6 billion over the programme period. Due to the projected increase in nominal GDP, these inflows are therefore expected to gradually decrease from 5.8% of GDP in 2024 to 5.1% in 2026, which is not sufficient to fully cover the current account deficit. Kosovo’s net international investment position slightly deteriorated to -18.8% of GDP in 2023, compared to almost -18% in 2022. Around two thirds of gross liabilities consist of foreign direct investment, limiting external vulnerabilities. Reserve assets are largely stable at just above 2 months of imports over the ERP period.

Table 2:

Kosovo - financial sector indicators

	2019	2020	2021	2022	2023
Total assets of the banking system (EUR million)	4 761	5 365	5 960	6 762	7 542
Foreign ownership of banking system (%)	86.7	86.5	85.5	84.9	84.3
Credit growth (%, average)	10.7	7.7	11.2	17.4	14.1
Deposit growth (%, average)	12.6	12.2	13.8	10.8	13.9
Loan-to-deposit ratio (end of period)	77.6	74.5	76.5	78.3	80.2
Financial soundness indicators (%, end of period)					
- non-performing loans to total loans	2.0	2.7	2.1	2.0	2.0
- regulatory capital to risk-weighted assets	15.9	16.5	15.3	14.8	15.8
- liquid assets to total assets	38.7	39.8	37.4	36.5	34.7
- return on equity	18.9	14.0	17.6	20.6	19.7
- foreign exchange loans to total loans	0.1	0.1	0.1	0.3	0.2

Source: Central Bank of Kosovo.

The mainly foreign-owned banking sector remained resilient and continued to expand at a robust pace. Annual bank lending growth decelerated to an average of 14.1% in 2023 from 17.4% in 2022, largely driven by slower growth in credit to businesses, reflecting tighter financing conditions. New loans to households, mostly for spending purposes, grew vigorously. The growth of bank deposits picked-up to an average of almost 14% in 2023 from 10.8% in 2022. Financial soundness indicators remained satisfactory, e.g. the loan-to-deposit ratio and non-performing loan (NPL) ratio[(4)] stood at 80.2% and 2%, respectively at end-2023. While bank profitability has slightly declined, with the average return-on-equity ratio falling to 19.7% in 2023 from 20.6% in 2022, the risks in the banking sector seem contained. Still, asset quality should be monitored closely in the context of higher interest rates and tighter liquidity. The ERP does not provide quantified forecasts for the financial sector but its underlying assumption is of a moderate increase in NPLs during 2024, necessitating increased provisioning for credit risks. Despite the fact that new mortgage lending to households declined in 2023, compared to relatively strong growth a year before, it would also appear appropriate to strengthen surveillance of the housing market, including by compiling residential sector statistics using bank loan data.

3. PUBLIC FINANCE

Fiscal consolidation continued in 2023 with a further reduction in the headline deficit due to strong revenue performance and despite a surge in public investment spending. The headline budget deficit stood at 0.2% of GDP in 2023, which corresponds to a surplus of 0.6% of GDP under the fiscal rule definition[(5)]. The headline deficit outturn was lower than in 2022 (0.5% of GDP) and significantly undershot the target of 3.6% set in the revised 2023 budget. The lower deficit resulted primarily from a strong increase in government revenue (+14.4% year-on-year), partly due to improved tax compliance and some formalisation gains.

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

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.

Tax revenue increased by 13% y-o-y, with direct and indirect tax income growing healthily by 18.4% and 11.1%, respectively. Public expenditure grew by 13.2% year-on-year due to a strong increase in capital spending (almost 33%), even though it only reached around 68% of the revised budget allocation, reflecting overoptimistic targets and weak implementation capacity. The execution of overall current expenditure was roughly in line with the revised budget plan. Wages and allowances recorded a strong increase of 17.3% y-o-y due to the implementation of the new law on salaries in the public sector since February 2023, while spending on goods and services rose by almost 16%. Government deposits fell to 2.4% of GDP, from 3.2% in 2022, reflecting higher nominal GDP, a shortfall of external budget support financing and a sizeable net negative domestic debt issuance.

The ERP objective for 2024-2026 is to maintain stable public finances and comply with fiscal rules, while supporting the economy mainly through higher capital spending. Over the programme period, public revenue is set to decline by 1.0 pp. to 28.1% of GDP by 2026, mainly due to a decrease in non-tax revenue, while tax revenue is projected to rise marginally in 2024 before stabilising at 25.6% of GDP in 2025-2026. Public expenditure is projected to increase by 0.7% of GDP over the ERP period to 30.1% in 2026, largely based on a very sizeable (2.2 pps.) upfront increase in capital spending in 2024, which brings public investment to around 8% of GDP, at which level it will remain over the programme period. Current spending is set to fall gradually by 1.1 pp. to 21.6% in 2026, driven by lower spending on goods and services as well as wages and salaries while transfers and subsidies are projected to remain stable as a percentage of GDP. After a large increase in 2024, the headline deficit and the deficit as per the fiscal rule definition are set to remain unchanged in 2025, compared to 2024, at 2.7% and 2% of GDP respectively, while they are projected to fall to 1.9% and 1.5% of GDP, respectively, in 2026. The implied fiscal impulse of 2.5 pps. in 2024 seems appropriate to support economic activity given the economic slowdown in 2023 and the sizeable uncertainty surrounding external demand as well as the emergence of a negative output gap before fiscal consolidation gradually resumes in 2025-2026.

Table 3:

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

	2022	2023	2024	2025	2026	Change: 2023-26
Revenues	27.9	29.1	28.7	28.2	28.1	-1.0
- Taxes and social security contributions	25.2	25.7	25.9	25.6	25.6	-0.2
- Other (residual)	2.7	3.4	2.8	2.6	2.5	-0.9
Expenditure	28.4	29.3	31.4	30.9	30.1	0.7
- Primary expenditure	28.0	29.1	31.0	30.4	29.6	0.5
of which:						
Gross fixed capital formation	4.7	5.9	8.1	8.1	7.8	1.9
Consumption	11.4	12.1	12.5	12.0	11.4	-0.7
Transfers & subsidies	11.9	11.0	10.1	10.1	10.1	-0.9
Other (residual)	0.0	0.0	0.2	0.2	0.2	0.2
- Interest payments	0.4	0.4	0.4	0.5	0.5	0.1
Budget balance	-0.5	-0.2	-2.7	-2.7	-1.9	-1.7
- Cyclically adjusted	-0.9	-0.2	-2.7	-2.8	-2.1	-1.8
Primary balance	-0.1	0.2	-2.3	-2.2	-1.4	-1.7
- Cyclically adjusted	-0.5	0.2	-2.3	-2.3	-1.5	-1.8
Gross debt level	20.0	17.3	18.8	20.4	21.4	4.2

Sources: Economic Reform Programme (ERP) 2024, Commission calculations.

The 2024 budget aims to provide a significant fiscal impulse, primarily through a large increase in investment spending, albeit with sizeable risks surrounding its execution. The 2024 budget projects public revenue to be 28.7% of GDP, slightly lower than the 2023 outturn of 29.1% of GDP. Tax revenue is expected to increase marginally to 25.9% of GDP, supported by higher GDP growth, a further reduction in the informal economy and improved tax compliance. Grants are set to decrease significantly by 62.5% year-on-year, reflecting base effects due to the EUR 75 million (0.8% of 2023 GDP) energy-crisis-related budget support from the EU in 2023. The assumed small rise in the tax revenue-to-GDP ratio looks plausible, due to authorities' initiatives to further strengthen tax compliance and tackle the informal sector[6]. Total expenditure is planned to increase to 31.4% of GDP from 29.3% in 2023, mainly due to a 2.2 pps. rise in public investment spending. Compared to the 2023 outturn, capital spending is set to increase by around 53%. Such a strong increase appears overly optimistic, given the previous track record in implementing spending, and would require a comprehensive overhaul of the institutional framework for investment planning and management. Moreover, such a strong surge in public investment is also not in line with the projections underlying the current IMF stand-by arrangement, which expects a small increase in capital spending in 2024 to 6.1% of GDP from 6% in 2023. Current expenditure is set to decrease by 0.5 pps. to 22.6% of GDP in 2024 reflecting the government's intention to gradually decrease less growth-enhancing budget allocations as well as better targeting of energy-crisis related temporary support to vulnerable consumers. Spending on goods and services is expected to grow by 0.6 pps. to 4.9% of GDP as a result of reclassifications from capital to current expenditure, mainly in the Ministry of Defense. Notwithstanding the planned increase in the salary coefficients as foreseen in the Law on salaries of public officials that came into force in February 2023, the wage bill is expected to decrease by 0.2 pps. to 7.6% of GDP. Debt interest payments are set to remain unchanged at 0.4% of GDP in 2024. The 2024 budget includes a 1.3% of GDP allocation for contingencies, of which 0.7% of GDP is a blanket allocation. This is significantly lower than in the 2023 budget (2.7% of GDP). Still, such blanket allocations undermine fiscal transparency and budget planning unless they are justified as part of a concrete risk assessment framework. The headline deficit is forecast to rise to 2.7% of GDP, 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 decline slightly to 1.7% of GDP from 2.4% in 2023, which is still in line with the fiscal rule, as no privatisation proceeds are planned.

While general government debt is projected to remain low, weaknesses linked to a narrow investor base and a lack of market access remain. On the back of a marginal primary surplus and high nominal GDP growth, the debt-to-GDP ratio decreased by 3.5 pps. to 17.2% in 2023. This is well below the 2023 ERP projection of 22.6% 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[(7)]. Domestic debt decreased significantly by almost 13% in 2023 and is held by a narrow investor base. The KPST is the largest investor and accounts for 46% of the domestic debt stock (down from 49% in 2022). The KPST still has room to buy new bond issuances in the coming years, but it is approaching the legal limit[8]. The appointment of new Board members in July 2023 allowed KPST to resume participation in the auction of Kosovo government securities in August. The share

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6 The Tax Administration of Kosovo (TAK) announced a new action plan to reduce informality in July 2023, and a tax procedures law was adopted by the government in December 2023.

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

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

held by commercial banks fell slightly to 24% from 25%; the share held by the Central Bank of Kosovo increased to 22% in 2023, from 19% a year earlier. Foreign debt rose by around 8% in 2023 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 and Development. The ERP projects a 1.6 pps. increase in the public debt ratio in 2024 to 18.8% of GDP and a continued gradual drift upwards to 21.4% of GDP in 2026. It projects government deposits to hover around 1.7% of GDP in 2024-2026, notably lower than the level expected in the previous year's ERP, which may not provide sufficient capacity to absorb potential new shocks. The lack of an international credit rating and access to international debt markets implies a need to diversify the investor base to ensure adequate financing. This could include insurance companies, non-financial private firms and possibly retail investors, including among the diaspora, which together currently hold only 8% of domestic debt. Kosovo is receiving technical assistance from the U.S Agency for International Development (USAID) to prepare an assessment for obtaining a sovereign credit rating from one of the three leading international credit rating agencies.

Debt dynamics

Kosovo

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

	2022	2023	2024	2025	2026
Gross debt ratio [1]	20.0	17.3	18.8	20.4	21.4
Change in the ratio	-1.6	-2.7	1.5	1.7	1.0
Contributions [2]:					
1. Primary balance	**0.1**	**-0.2**	**2.3**	**2.2**	**1.4**
2. 'Snowball effect'	**-1.9**	**-1.3**	**-0.8**	**-0.8**	**-0.8**
Of which:					
Interest expenditure	0.4	0.4	0.4	0.5	0.5
Growth effect	-1.0	-0.7	-0.7	-0.8	-0.8
Inflation effect	-1.3	-1.0	-0.5	-0.4	-0.4
3. Stock-flow adjustment	**0.2**	**-1.2**	**0.0**	**0.2**	**0.4**

[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) 2024, Commission calculations.

The primary balance is projected to turn negative in 2024 and maintain a (gradually shrinking) deficit in 2024-2026, which is expected to drive the moderate increase in the public debt ratio over the same period. This debt-increasing factor is set to be partly offset by the impact of buoyant economic growth and, to a more limited extent, inflation. Interest expenditure is forecast to stay low and rougly stable at 0.5% of GDP in 2024-2026. Slightly positive contributions to the debt-to-GDP ratio are expected to come from stock-flow adjustments in 2025 and 2026, although their origins are not explained in the ERP.

Significant risks and uncertainties surround the fiscal scenario. Fiscal projections are likely to underestimate current spending, while the assumption of a surge in capital spending in 2024 appears unrealistically large. On the spending side, the decrease in the allocation for transfers and subsidies as a percentage of GDP seems rather benign, even if the elimination of untargeted government electricity subsidies, following the increase in electricity tariffs in March 2023, is taken into account. There is a risk that transfers and subsidies might decrease less than the targeted 1.4% or even increase in 2024, compared to the 2023 outcome, due to the repetition of initiatives such as raising basic pensions with one-off top-ups and child benefits[(9)], while existing schemes might prove more costly than expected. In particular, spending on war veteran pensions has repeatedly breached the legal cap of 0.7% of GDP in the absence of a reclassification of beneficiaries. The law adopted on 13 July 2023, which decouples war veterans' pensions from the minimum wage, would help contain overspending risks. However, the law is currently being reviewed by the constitutional court (following a request by the opposition) and it will not be decreed by the President before the court's ruling is received. The planned decrease in the wage bill also looks optimistic given the previous track record in this area. The projected increase of more than 50% in capital spending, compared to the 2023 outturn, seems overly ambitious given the track record in previous years and limited progress in improving planning, selection and management capacities for public investment.

Additional fiscal risks stem from poor financial oversight and accountability as well as weak governance of Publicly Owned Enterprises (POEs) which could require (further) large subsidies[10] from the budget. Despite recent improvements in monitoring the fiscal risks emanating from POEs' operation, the approval of their annual performance report for 2022 has been delayed and the law that regulates their corporate governance has become obsolete as it 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 have a key role in improving the management and financial performance of POEs[11]. The 2024 budget includes an allocation of only EUR 3 million for reimbursing the COVID-19-related 10% withdrawal of pension savings from the Kosovo Pension Saving Trust (KPST)[12], thereby requiring higher allocations in the following years' budgets to meet this liability. On the revenue side, the projected rise in tax revenue of around 9% in 2024 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. Overly optimistic GDP growth projections are also a downside risk for revenue.

Sensitivity analysis

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

1) If the deficit rule is followed and there is a slowdown in GDP growth of 1 percentage point in 2027-2036, debt would increase to 34.9% of GDP by the end of 2036 instead of 32.8% in the baseline scenario

2) If the deficit rule is not followed and the primary balance deteriorates by 1 percentage point of GDP in 2027-2036 due to higher spending, debt would increase to 37.7% of GDP by the end of 2036, i.e. 4.9 percentage points higher than in the baseline scenario.

3) No compliance with the deficit rule and a 1 percentage point increase in interest rates on loans,

9 These initiatives were taken in December 2023 with a fiscal cost of around EUR 69 million. The child benefits are not laid down in the respective legislation yet (apart from the Law on budget appropriations), while basic pension top-ups are implemented based on ministerial decisions.

10 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.

11 The law on the establishment of a sovereign fund is being reviewed by the constitutional court.

12 The framework provides for five annual instalments of EUR 20 million each as of 2023. Only EUR 5 Million were disbursed in 2023.

would bring the debt-to-GDP ratio to 38.8% by the end of 2036, i.e. 6 percentage points higher than in the baseline scenario.

The sensitivity analysis highlights the importance of complying with the 2% deficit rule, which acts as a debt stabiliser. Moreover, in view of the expected termination of financing from privatisation funds in the medium term, it is important to keep current expenditure under control.

The efficiency of public spending suffers from long-standing issues such as inappropriate targeting and transparency of social transfers. Although temporary energy-crisis related support for vulnerable households and firms was mostly well-targeted through means-testing procedures, a large share of specific category-based social transfers, including war-related pensions, which are non-contributory and financed from the budget, do not directly focus on reducing poverty.

Strengthening public investment management would support a shift to a more growth-enhancing budget structure. According to IMF estimates Kosovo has lower relative levels of capital stock than peer countries[13] and a lower growh rate in its real public capital stock[14]. Weaknesses persist at the planning phase of public investment projects. Many of the projects do not undergo a proper appraisal and selection process as set out in the administrative instructions on project selection and the related public investment programme manual. Furthermore, the administrative instructions do not integrate a climate-awareness perspective in the appraisal and selection of capital projects. The latter are therefore not ready for implementation when approved. Project oversight is also weak, which impedes corrective action when needed. On a positive note, steps were taken to unlock the potential of project implementation, including through the Ministry of Finance Labour and Transfers (MoFLT) budget circular, which requires budget organisations to include expropriation costs as part of the project envelope. Furthermore, technical evaluation and documentation on new externally-financed projects should be finalised before the corresponding financial agreements are signed. Shortcomings in managing public investment could be addressed by establishing the linkages among the e-procurement and Kosovo Financial Management Information (KFMIS) systems, as recommended under the IMF's updated public investment management assessment.

Continued tax policy reforms are essential to strengthen the revenue base. Kosovo's tax regime is plagued with numerous tax exemptions, preferential tax rates and special regimes, all of which erode the tax base. For this reason, it is necessary to undertake and publish a review of tax expenditure quantifying the revenue foregone on account of these practices. Furthermore, to reduce loopholes and exemptions the government is preparing amendments to the legislation on personal income tax (PIT), corporate income tax (CIT) and value added tax (VAT). These tax policy reforms are essential for raising revenue to compensate for the expected loss in customs revenue due to the implementation of the free trade agreement with Türkiye and the Stabilisation and Association Agreement with the EU.

The existing system of fiscal rules provides the main anchor for fiscal policy while safeguarding high out-of-budget capital spending. The 2024 budget appropriately aims to

13 Albania, Bosnia and Herzegovina, Croatia, Montenegro, North Macedonia, Serbia, and Slovenia.

14 Public capital stock in 2019 for Kosovo was estimated at 49.2% of GDP while it was at 82.3% for Albania, 75% for Croatia, 73.9% for Bosnia and Herzegovina, 63.4% for Montenegro, 57.4% for Slovenia and 34.5% or Serbia. Kosovo's real public capital stock growth was negative on average during 2014–2019. In contrast, real capital stock growth was estimated to be growing solidly for the peer countries in the region.

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 2025 before decreasing to 1.5% of GDP in 2026. However, 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. Despite the planned increase in the salary coefficients due to the implementation of the law on salaries of public officials, the wage bill is expected to decline by 0.2 pps. to 7.6% of GDP in 2024, so 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. Fiscal governance would also benefit from setting-up an independent, fiscal oversight body. It is therefore regrettable that the authorities do not seem to have the intention of advancing towards the establishment of a Fiscal Council.

4. MAIN MACRO-RELEVANT STRUCTURAL CHALLENGES

In November 2023, the Commission proposed a New Growth Plan for the Western Balkans[15] with the aim of supporting the region's economic convergence and accelerating the accession process. The plan involves a Reform and Growth Facility (EUR 2 billion in grants, EUR 4 billion in loans) that is to be disbursed in 2024-2027 as investment[16] and budget support, in exchange for implementing reforms that are to be set out in Reform Agendas prepared by the Western Balkan partners. The New Growth Plan is therefore an important tool for increasing reform incentives to boost growth and convergence. In this context, with a view to ensuring an integrated surveillance of Kosovo's economy, this chapter briefly outlines the main structural challenges facing Kosovo.

Kosovo's corporate structure is dominated by family-owned small and micro companies mostly operating in the services sector. The services sector dominates economic activity, providing around 45% of gross value added in 2022 and 73% of employment. Besides travel services driven by the diaspora, which dominate the services sector, the ICT sector has also been growing at a fast pace. The share of industry in gross value added stands at almost 20%. Mining only accounts for a small share of GDP due to under-investment over the past three decades, while the manufacturing base is narrow. Kosovo is weakly integrated into global value chains, with goods exports comprising mostly low-value-added, unsophisticated products. Foreign direct investment, which could improve the competitiveness of the economy has mostly gone into non-tradeable sectors, primarily real estate.

Kosovo faces challenges in its business environment. The regulatory and institutional environment remains a key obstacle to private-sector development and competition. Kosovo's economy struggles with a large informal sector, weak rule of law and corruption, all of which impede its attractiveness for foreign and domestic investors. A high administrative burden for businesses and citizens, weak law enforcement and dispute settlement and limited access to finance continue to be serious development obstacles despite government programmes to improve the business environment. The Commercial Court, which became fully operational in

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[15] https://neighbourhood-enlargement.ec.europa.eu/enlargement-policy/new-growth-plan-western-balkans_en.

[16] Infrastructure investments need to comply with the EU environmental acquis, national and international nature protection and water management obligations, ensure public participation and consultation, and guarantee high quality environmental impact assessment reports that include cumulative impacts on nature and biodiversity.

August 2022, is expected to increase the efficiency of the judicial system[17] in settling commercial disputes, but the court still faces a large backlog of cases. Despite some new initiatives undertaken by the Kosovo Credit Guarantee Fund, the lack of easily accessible and affordable credit continues to be a barrier to companies' growth, due to banks' stringent loan requirements, which affect mostly smaller companies.

Widespread informal activity impedes economic development. According to estimates, the informal sector accounts for around 30% of GDP. First, it reduces the tax base, limiting the fiscal space to invest more in priority areas such as education, health and infrastructure. Second, it creates an uneven playing field among businesses and is a deterrent for additional, much-needed private-sector investment, including foreign direct investment. Unfair competition from informal businesses has consistently been identified as a major obstacle to doing business in Kosovo (World Bank et al, 2019a; EBRD, 2016)[18]. Informality also impairs the competitiveness and export potential of Kosovo's private sector: firms operating in the informal sector have more difficulty accessing finance and tend to engage less in research and development and innovation and to hire fewer workers. Lastly, workers in informal sectors have more limited (or no) access to social protection and additional benefits, and are therefore more vulnerable when they lose their job or leave the labour market. Their access to training is also negatively affected, which exacerbates the inadequacy of skills in the workforce and contributes to the migration of specialised and skilled workers to markets where better labour and wage conditions can be found. Conversely, the lack of social and other benefits in formal employment – given the lack of structures to provide them – discourages many informal employers and employees from formalising working arrangements.

The supply of energy is unreliable and insufficient to meet rapidly growing demand and is one of the main constraints on Kosovo's competitiveness, curbing productivity. The reliability of energy supply is still below the average for Europe and Central Asia. Despite some improvements, Kosovo ranks 90th in the world for ease of getting electricity[19]. The lack of energy security gives rise to significant costs for business and represents one of the biggest obstacles to attracting high-quality foreign direct investment while also putting pressure on public finance. Kosovo also suffers from high technical and commercial losses in distribution and transmission grids, which stood at around 25% in 2021. More than 90% of electricity is produced by two outdated, unreliable and highly polluting lignite power plants, which the government plans to refurbish. The share of renewables in electricity generation is rising, but remains small. Their roll-out is expected to accelerate through the energy strategy adopted in March 2023 and the law on renewable energies, which has passed the first Assembly reading. The National Energy and Climate Plan (NECP), which should include the Energy Community Secretariat's recommendations, is pending the final adoption by the government.

The digital transformation of the economy is advancing step by step, but the digitalisation of public services is still at an early stage. 100% of households nationwide have access to fixed broadband electronic communications infrastructure. Fixed access

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17 The court is efficient in communicating its results to the public through a user-friendly online portal, improving transparency efforts.

18 The *2019 Enterprise Survey* put informality as the single most pressing obstacle perceived by business in Kosovo, with 26% surveyed companies listing it first, well above the 19% of surveyed firms in the region selecting this option (WB et al., 2019). Similarly, according to the 2016 business environment and enterprise performance survey (BEEPS V), competition from informal competitors was signalled as the single most important issue in Kosovo. In all, 66% of firms reported that having to compete against firms in the informal sector was a major issue, the highest among all 30 countries covered in BEEPS V (the average was 39%). (EBRD, 2016)

19 World Bank (2020b), Doing Business 2020: Comparing Business Regulation in 190 economies.

internet penetration is estimated to be 129% of households, compared to 89% in the EU, and mobile telephony penetration is around 98% of the population. Kosovo has a small but rapidly growing ICT sector, particularly in the export of software development, smart phone application development and web design. Despite some improvements in implementing e-commerce programmes, there seems to be little progress in increasing the adoption of e-commerce practices among SMEs. The Digital Agenda strategy covering the period up to 2030 was approved by the government at end-June 2023. It provides a comprehensive framework for digital transformation, including 5G technologies and the digital transformation of businesses and public services.

The labour market situation remains challenging while the education system is not adequately aligned with labour market needs. Only around 40% of the working-age population is active while the unemployment rate is persistently high. The share of young people (aged 15-24) not in employment, education or training (NEET) was very high in 2022, at 33%, far above other Western Balkan peers. An increasing challenge is emigration, with current estimates[20] suggesting that more than one third of the polulation lives abroad as more educated and young people are seeking employment there. There are also significant gender differences in the labour market as around 80% of working-age women are economically inactive while those who are economically active are less likely than men to be employed. Capacity and staffing issues in the employment agency and the public employment services are delaying the implementation of the "Youth Guarantee" plan and other labour market support schemes. Despite some educational reforms, scores on the OECD's 2022 Programme for International Student Assessment (PISA) are very low and unemployment among tertiary education graduates is still high, pointing to the inadequate quality and relevance of education. The 2022-2026 education strategy, adopted in October 2022, aims to raise the quality of pre-university education and, in particular, to harmonise education and professional training. It also fully recognises the need to develop a real-time information system and forecasting on labour market needs, as well as a standardised methodology for labour market research. This commitment has yet to be translated into action.

[20] D. Hazer, T. Cela, A. Krasniqi and V. Cenaj (2021), Economic and Tourist Effects of External Migration in Kosovo, Journal of Environmental Management and Tourism, 12(2): 50 (available at: https://journals.aserspublishing.eu/jemt/article/view/5979)

ANNEX 1: OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2023

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey has adopted targeted policy guidance for all partners in the region. 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 2023 policy guidance jointly adopted by the EU and the Western Balkans and Turkey at their Economic and Financial Dialogue at ministerial level on 16 May 2023.

Overall: Partial implementation (43.1%)[21]	
2023 policy guidance (PG)	**Summary assessment**
PG 1: If needed, use the available fiscal space in the 2023 budget to provide well-targeted and temporary energy crisis-related support to vulnerable households and businesses whilst ensuring compliance with the 2% deficit ceiling of the fiscal rule as envisaged by the ERP.	There was **partial implementation** of PG 1. **1) Substantial implementation:** In 2023, the government allocated and implemented around EUR 30 million (0.3% of GDP) to temporary energy-crisis related support for vulnerable households and firms by subsiding: a) electricity bills to mitigate the impact of tariff increases; b) the purchase of energy efficient equipment; c) monthly electricity bills of around 200 thousand households which saved energy, compared to the same period a year before, by double the rate of saving. These measures were well-targeted, because public authorities examined each beneficiary's application based on a means test, instead of automatically transfering financial support. Nevertheless, the one-off transfers to basic pension and child allowance beneficiaries, totalling around EUR 69 million (0.7% of GDP) at end-2023, were not targeted. Supported by slower than anticipated implementation of capital projects and solid revenue performance, the headline budget deficit fell to an estimated 0.2% of GDP in 2023, which corresponds to a surplus of 0.6% of GDP under the fiscal rule definition.
Ensure that spending on war veteran pensions as well as public-sector salaries according to the new wage law comply with the prescribed legal ceilings.	**2) Partial implementation:** While the Law on salaries of public officials, which had come into force on 9 February 2023, set the value of the wage coefficient at EUR 105 for 2023, the increase of EUR 113 million in the public wage bill was lower than nominal GDP growth in 2022, thus the wage bill rule was respected.

[21] 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.

Undertake and publish a review of tax expenditure quantifying the size of the revenue forgone from all exemptions, preferential rates and special regimes.	In relation to war veteran pensions, there has been no progress in re-classifying the beneficiaries list. The law adopted on 13 July 2023, which decouples war veterans' pensions from the minimum wage, would help contain overspending risks. However, the law is being currently reviewed by the constitutional court and it will not be decreed by the President before the court's ruling is received. There was a slight breach of the legal ceiling of 0.7% of GDP in 2023 as actual expenditure for this pension scheme exceeded the annual budget allocation by EUR 0.84 million and amounted to almost 0.8% of GDP. However, this is lower than the actual expenditure of 2022 (0.9% of GDP). **3) Limited implementation:** The World Bank is providing technical assistance to the MoFLT to prepare a comprehensive tax expenditure report. In December 2023, the government published a report summarising the main fiscal developments in 2022. The report provides a preliminary quantification of the size of the revenues forgone due to some of the tax exemptions and reduced rates in 2022.
PG 2: Increase the execution rate of capital spending by implementing the recommendations made under the IMF's Public Investment Management Assessment. Improve financial oversight and accountability of Publicly Owned Enterprises (POEs), including by approving and publishing their annual performance report.	There was **limited implementation** of PG 2: **1) Partial implementation:** Despite the authorities' efforts, the under-execution of capital expenditure remains a challenge for Kosovo. The execution rate increased only to around 68% in 2023, from 60% in 2022, but the year-on-year increase in public capital spending was substantial at almost 33%. This outcome benefited from: i) the re-operationalisation of the Procurement Review Body board in late 2022; ii) the implementation of the Law on public works support, adopted at the end of 2022, compensating contractors up until mid-2023 for higher project costs resulting from very high inflation at the time; iii) the budget circular approved in May 2023 requiring budget organizations to include expropriation costs as part of the project envelopes. The IMF's Public Investment Management Assessment (PIMA) update in June 2023 assessed that while several previous recommendations have been implemented, significant work remains, particularly at the planning stage of the investment cycle. Strengthening project appraisal, investment planning, and the MoFLT review function are priorities. Specifically, many of the projects do not undergo a proper appraisal and selection process as set out in the administrative instructions on project selection and the related public investment programme manual. These projects are therefore not ready for implementation when approved. **2) Limited implementation:** The annual POEs performance report for 2022 has been submitted by the Ministry of Economy (in charge of supervising the central POEs) to the government and its approval is pending. The 2021 performance monitoring report was approved by the government in December 2022 and has been published on the Ministry of Economy's website, in Albanian only. 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 November 2023. 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. As of Q1-2022 a quarterly report on the financial situation of POEs has been available on the Ministry of Finance's website, with better data quality. A section on POEs' borrowing is also included in the quarterly debt report (in line with the requirements of the new Law on state debt, adopted in December 2022). The Ministry has also started assessing fiscal risks on loans that are requested by POEs. The law on the establishment of a sovereign fund was adopted by the Asembly 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 strenghten their management and attract private capital. The fund will operate as an autonomous public institution under the supervision of the Assembly. A concept document has been submitted to the government by the relevant working group, but there were no developments in amending the law on POEs with the aim of aligning their corporate governance with recognised international standards.
Review the options paper on the establishment of an independent body for fiscal oversight and inform the Commission about the follow-up.	**3) No implementation:** The government has not taken any steps to set up the independent body for fiscal oversight, following finalisation of the options paper on the matter.
PG 3: Continue to carefully assess and analyse price developments and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability.	There was **substantial implementation** of PG 3. **1) Substantial implementation:** The central bank carefully monitored the evolution of price dynamics. However, no macroprudential tools have so far been used, for instance to curb credit growth. Fiscal policy as the main tool for demand management remained prudent overall.
Continue efforts to ensure that core areas of the central bank, including financial stability and banking supervision, are adequately staffed to deepen the central bank's analytical and technical capacities..	**2) Substantial implementation:** The central bank is in the process of a functional reorganisation in line with the new Strategic Plan and intends to strengthen core policy areas also by recruiting additional experts. Efforts to enhance macroeconomic and stress-test modelling capacities are ongoing. Nonetheless, given the low starting point, efforts will need to continue. Increasing the attractivity of positions in core areas is key to attracting and retaining skilled staff.
Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality, further reduce remaining obstacles to NPL resolution and reduce data gaps in particular as regards the real estate sector.	**3) Partial implementation:** Asset quality is reported in accordance with IFRS9, the NPL ratio remained low, with adequate provisioning. Reporting of the liquidity coverage ratio in line with Basel III started in January 2023. In addition, the central bank initiated more frequent and

	detailed risk and liquidity reporting by banks. The central bank plans to amend legislation to enable the development of a secondary market for NPLs. Initial steps have been taken to address data gaps in the real estate property sector, but significant further progress is needed to allow for improved surveillance.
PG 4: In line with the Green Agenda for the Western Balkans, enhance energy resilience and transition by completing the legal framework and launch the pilot auction on renewables. Implement the 2023 Energy support action plan including energy efficiency measures. Improve system resilience, modernize the electricity grids and operationalise the wholesale day-ahead and intra-day electricity price markets on the path toward retail electricity market liberalisation.	There was **partial implementation** of PG 4. **1) Partial implementation.** Kosovo launched its inaugural solar auction in May 2023. Overall, the auction was considered a success, with six companies submitting offers. The process was deemed open and transparent, with the government being responsive to various requests from interested investors. Additionally, in March 2023 the government approved the new Energy Strategy for 2022-2031 and its implementation plan, setting ambitious targets for renewable energy sources. However, the Law on Renewable Energy Sources is still pending adoption by the Assembly[22]. **2) Partial implementation.** Through the 75 million EU Energy Support Package for Kosovo, the government implemented various measures in 2023 to mitigate the effects of rising energy prices on households and businesses. By end of 2023, approximately €30 million had been executed on implementing different measures, including incentivising households to save energy, subsidies for insulating houses and installing energy-efficient heating equipment in both households and businesses. Targeted support was provided to families under the Social Assistance Scheme, including subsidies for biomass and their energy bills. Medium to long-term measures planned in the EU Energy Support Package are still to be implemented. **3) Limited implementation.** The go-live of the day-ahead electricity market to be operated by the Albanian power exchange ALPEX, as well as day-ahead market coupling of Kosovo – Albania, has been operationalised. The bulk supply agreement between Kosovo Energy Corporation (KEK) and the universal supplier KESCO is still in place. This impedes the further development of the wholesale market.
PG 5: Increase the implementation rate of the action plan of the 2019–2023 National Strategy for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes.	There was **partial implementation** of PG 5: **1) Partial implementation.** In March 2023, the Ministry of Finance published the 2021-2022 annual report on the implementation of the National Strategy of Kosovo for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes 2019-2023. According to the report, of 71 activities, 44 (62% of them) were implemented, while 27 (38% of them) have not been implemented yet. The 2022-2023

[22] The Law has passed first Assembly reading while a second reading is pending.

	annual report is still being prepared.
Continue to incentivise formalisation of employment and businesses and address tax evasion in identified high-risk sectors through better inter-institutional cooperation.	**2) Partial implementation.** In July 2023, the Tax Administration of Kosovo (TAK) adopted a new annual action plan to reduce the informal economy with the focus on addressing the incorrect or non-declaration and non-payment of personal income tax obligations, and to identify the high-income taxpayers who do not file or incorrectly file personal income tax obligations by using information from different sources. In addition, to improve revenue mobilisation through digitalised processes, TAK launched 3 new digital services for taxpayers (in total there are 11 online services available), one of which allows taxpayers to report on tax irregularities. In December 2023, the Assembly adopted the Law on Administration of Tax Procedures. This law amended the legal requirement on a number of issues that impact the formalisation of economic activities or undeclared work, such as requirements to pay all salaries electronically to financial institutions, or employment contracts to be concluded and be notified to TAK a day before the employee starts working. It also regulated important sharing and information gathering with third parties, such as commercial banks, and partner countries. Other amendments include the requirement to reduce cash transactions to EUR 300 Euro.
Simplify the system of licenses and permits, and complete the restructuring of SME and investment promotion agencies and ensure adequate resources.	**3) Partial implementation.** According to the annual report covering the 2022-2023 period on the implementation of the 2022-2027 government program on prevention and reduction of administrative burden (ABR), 10 activities have been undertaken to develop methodologies or other tools to implement the programme, such as analyses, guides and catalogues. The analysis of independent institutions, which includes 110 permits, has begun, including a digitalisation analysis for another 150 permits. The implementation of the ABR programme is progressing in accordance with the timelines set in the programme. The Law on sustainable investment has passed all Assembly procedures and the Office of the Prime Minister has consulted stakeholders and put in place a proposed structure for organisation. However, the restructuring has to wait for the Constitutional Court's decision, as the Law was challenged for interpretation by some opposition parties. Funds were allocated in the 2024 budget law for both agencies, as planned in the 2024-2026 Medium-Term Expenditure Framework (MTEF).
PG 6: Develop a roadmap for the implementation of key reforms of the education system, including the recommendations under the ETF Rapid Education Diagnosis.	There was **limited implementation** of PG 6: **1) No implementation.** The government has developed the 2022-2026 National Education Strategy, published in September 2022, but it has not been updated since the Rapid Education Diagnosis was published in 2023, and no roadmap has been developed. In addition, the organisation chart of the Ministry of Education, Science, Technology and Innovation (MESTI) is still pending approval. Additional resources for several departments, such as

	digital department and monitoring, have not been allocated. Implementation of support for early childhood education, which includes the development and implementation of new curricula, has not yet started.
Align education, particularly higher education programmes and vocational education and training, with labour market needs by closely cooperating with the business community, to further develop the employment barometer and skills barometer.	**2) Limited implementation.** Kosovo has started implementing the dual education approach (51% of learning done in companies) based on the example of Germany, Austria, Switzerland and the positive experiences of its diaspora. The reform effort is being supported by a task force on dual education. Reforms to ensure that the VET system aligns with labour market needs are ongoing. However, VET profiles offered by vocational schools remain largely unaligned with occupational standards and labour market demands. The authorities have increased the number of scholarships for students, including women in science, technology, engineering, and mathematics (STEM), to address the skills mismatch. The Ministry of Education, Science, Technology and Innovation has launched a campaign for the image of vocational education and training, to promote the benefits of a dual education system.
Speed up the ongoing restructuring of public employment services and significantly increase their capacity to provide relevant services in particular in view of the implementation of the Youth Guarantee and the delivery of relevant active labour market measures for the unemployed and those at risk of becoming unemployed.	**3) Partial implementation.** The piloting phase of the Youth Guarantee has started in two municipalities. Staff recruitment in the respective local employment agency offices is ongoing. However, there exists for now no quality offer to help the young people supported under the scheme. The necessary steps include the approval of the Active Labour Market Measures (ALMMs) regulation and allocating budget to the Youth Guarantee implementation. The 2023–2027 Employment Strategy has been finalised, although adoption is still pending. A new Law on employment is still in the drafting process and will include provisions regulating the employment agency and delivery of employment services. The draft Law on Youth was adopted by the government in the reporting period. The restructuring of the Employment Agency is still underway, and budget has been increased to procure training, adapt training programmes to the needs of the market and use the training centres more efficiently.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted the Economic Reform Programme for 2024-2026 and submitted it to the Commission on 16 January 2024, within the set deadline. It is in line with the previously approved medium-term fiscal strategy and national development strategy. No 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, in close cooperation with the Strategic Planning Office in the Prime Minister's Office. They were supported by policy area coordinators from the line ministries. The inter-ministerial coordination process worked well.

Stakeholder consultation

The draft ERP was made available online with 2 weeks for stakeholders to provide their feedback, in line with the rules on minimum criteria for public consultation. Commission staff dealing with the ERP held consultations with representatives from civil society organisations, business organisations, international financial institutions and donors. Written comments are annexed to the ERP with an indication of whether they have been accepted or rejected, though they include only comments from one agency within the Prime Minister's Office.

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 October 2023 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, a decline in remittances and higher financing costs for the banking sector. The forecasts for the labour market and the financial sector are still lacking.

Fiscal framework

The fiscal projections are based on the adopted 2024 budget. For 2024, the ERP forecasts a decreased public revenue-to-GDP ratio, whereas public expenditure is set to increase from the 2023 level, mainly due to a large surge in capital investment. Some of the 2023-2024 fiscal data are not consistent with the main text. The ERP provides a useful debt sustainability analysis with three negative shock scenarios.