Council of the
European Union

Brussels, 16 May 2023
(OR. en)

9478/23

ECOFIN 442
UEM 100
COWEB 63
ELARG 31

COVER NOTE

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

Delegations will find attached the text of the Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye as approved by the participants of the Dialogue on 16 May 2023.

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

The Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye, Brussels, 16 May 2023

Representatives of the EU Member States, the Western Balkans and Türkiye, the European Commission and the European Central Bank, as well as representatives of the central banks of the Western Balkans and Türkiye met for their annual economic policy dialogue. The dialogue aims to prepare the future participation in the European Semester of the Western Balkans and Türkiye (Montenegro, the Republic of Serbia, the Republic of North Macedonia, the Republic of Albania, Bosnia and Herzegovina, and the Republic of Türkiye are candidate countries for EU accession, while Kosovo[*] is a potential candidate).

The economic impact of Russia's war of aggression against Ukraine has confronted EU Member States, the Western Balkans and Türkiye with major economic and social challenges. Participants agreed that the economic policy dialogue is of high importance in view of a common interest to define appropriate policy responses also to the recent adverse shocks. Participants emphasised the common position by the EU and the Western Balkans and Türkiye in deploring in the strongest terms the continued military aggression by the Russian Federation against Ukraine. In view of high uncertainty about potential further impacts of Russia's war against Ukraine, participants considered it appropriate to stand ready to mitigate, if needed, adverse impacts on growth, employment and social cohesion by adequately targeted, temporary and transparent fiscal and financial measures while keeping an appropriately tight fiscal stance in 2023 and beyond to help lower persistent high inflation and preserve fiscal sustainability. Confronted with growing instability, strategic competition and security threats, the EU has taken more responsibility for its security and has taken further decisive steps towards building European sovereignty, reducing dependencies and building a more robust economic base to support a sustainable, resilient, competitive and inclusive Europe. Participants agreed that these objectives are also relevant for the Western Balkans and Türkiye and recommitted to the economic and financial dialogue as it contributes to the wider goals of good governance, including the rule of law, and economic prosperity. In order to strengthen economic resilience in the longer term, all participants committed to accelerating the green and digital transition of the Western Balkans and Türkiye in line with commitments related to targets for greenhouse gas emissions reduction, energy efficiency and renewable energy for 2030. They also recall the importance of enhancing human capital development and social inclusion, particularly of young people. This should be supported by the appropriate and efficient use of EU financial support through the Instrument for Pre-accession and the European Fund for Sustainable Development Plus.

Participants underlined that the earthquakes of 6 February 2023 in Türkiye represent, first and foremost, a very large humanitarian crisis, and expressed solidarity with Türkiye. While the full economic impact of the earthquake is yet to be assessed, participants agreed that the amount of losses and the reconstruction costs will require the mobilisation of very substantial financial resources. As such, participants underlined that this year's Economic Reform Programme assessment, which is based on a set of assumptions preceding the earthquakes, would need to be read in conjuction with Türkiye's revised priorities following these events.

[*] 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.

Looking beyond the current challenges, participants agreed that the economic policy dialogue should continue to play a central role in providing jointly agreed policy guidance to support a sustainable medium-term economic recovery and help the enlargement partners to gradually meet the economic criteria for EU accession. Participants underlined their commitment to this economic and financial dialogue and encouraged the Western Balkans and Türkiye to fully implement the macro-fiscal and structural policies and reforms as outlined in their programmes to foster a sustained recovery. Participants emphasised that ownership will be key to a successful implementation of the jointly agreed policy guidance. Participants welcomed the Progress report on the action plan on economic, monetary, and financial statistics for the Western Balkans and Türkiye and appreciated its high quality. Participants regretted that Bosnia and Herzegovina's Economic Reform Programme had again been submitted with a significant delay. The dialogue will continue in 2024, including on the implementation of these conclusions and will be extended to Ukraine, Moldova and Georgia[1].

[1] On 23 June 2022, the European Council granted the status of candidate country to Ukraine and to the Republic of Moldova and recognised the EU membership perspective of Georgia.

Albania

Albania submitted its Economic Reform Programme (ERP) 2023-2025 on 31 January 2023, though the final text was only adopted by the government on 1 March 2023. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2022 has been partially implemented.

Albania's economic recovery continued despite the mainly indirect impact of Russia's invasion of Ukraine, in particular from higher energy and food prices. Driven by private investment and consumption, GDP growth was higher than expected at 4.8% in 2022. The ERP expects economic growth to slow to 2.6% in 2023 due to a less favourable external environment dampening services exports, in addition to tighter financing conditions and increased uncertainty affecting private consumption and investment. In 2024, economic growth is projected to rebound to 3.9% and stay close to this rate in the medium term, mainly supported by private consumption and investment and exports. Moderate employment growth in 2023-2025 is expected to gradually reduce the unemployment rate, to 9.8% by 2025.

Following strong revenue growth, considerable savings on interest and personal expenditure, as well as underexecution of foreign-financed public investment, the 2022 budget deficit was lower than originally envisaged and amounted to 3.7% of GDP, despite additional spending to shelter households and SMEs from high energy and food prices. Supported by increasing revenue, including the EU's new energy-related budget support, the budget deficit is set to fall further in 2023, to 2.6% of GDP. In the medium term, a decreasing expenditure-to-GDP ratio is planned to keep the budget deficit just above 2% of GDP and the primary balance positive from 2023, in accordance with the new fiscal rule. The public debt ratio dropped much more than expected in the ERP to 64.6% of GDP in 2022, below its pre-pandemic level of 2019. The ERP forecasts a continuous reduction of the public debt ratio by about 1 pp per year.

The planned fiscal consolidation is needed to gradually rebuild fiscal space and should rely more on increasing the tax revenue ratio through well-prepared reforms to taxes and social security contributions in line with the draft medium-term revenue strategy and after considering comments of civil society stakeholders. Raising more revenue is also crucial to finance the necessary increase in productivity-boosting investments into human and physical capital and should be coupled with higher expenditure efficiency in particular through improved public investment management processes fully integrating public-private partnerships (PPPs). This should be complemented by a tighter control of fiscal risks, a continuing reduction and prevention of public-sector arrears and increased transparency of budget revisions. Albania should refrain from establishing any scheme or other measure such as tax and criminal amnesty legislation which could compromise or undermine alignment with the EU *acquis* and policies, including EU procedures and measures aimed at preventing money laundering and tax evasion, also with a view to fulfilling the necessary criteria for a de-listing by the Financial Action Task Force (FATF).

Headline inflation peaked at 8.3% in October 2022, while remaining the lowest among regional and EU peers. Broadening price pressures have led the Bank of Albania (BoA) to embark on a tightening cycle, from a historically low level of 0.5% in March 2022 to 2.75% in November and then to 3% in March 2023, with a temporary pause motivated by lower-than-expected inflation, steady currency appreciation and faster-than-expected transmission to government security yields. Still high inflationary pressures and medium-term expectations above the inflation target require high vigilance and readiness to tighten monetary policy further. The BoA has also resumed pre-announced purchases of forex reserves, further strengthening external buffers. The banking sector remained stable, well-capitalised and liquid, with profitability under pressure via valuation effects on debt security holdings. A phase-in of macroprudential capital buffers is ongoing. The non-performing loan (NPL) ratio has declined further but remains elevated. Slowing activity and tightening monetary conditions exacerbate credit risks, warranting close monitoring, a transparent reporting of asset quality and further progress on data availability, in particular as regards real estate statistics. There has been some progress on removing remaining obstacles to NPL resolution, particularly on the bailiff impasse. Increased ownership of banks by non-financial groups and local individuals calls for increased vigilance, a prudent licensing framework and ensuring that fit-and-proper criteria are met on an ongoing basis. Currency substitution levels are high and increased further, impeding the transmission of monetary policy and remaining a latent risk to financial stability.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine in the year ahead the potential for maintaining economic resilience as well as boosting inclusive growth, competitiveness, jobs creation, while accelerating the transition to a greener and more digital economy for meeting increased external market pressures.

To promote competitiveness, Albania also needs to tackle corruption, improve the rule of law, and strengthen institutions. It also needs to address the challenges of the green transition, including preparation for the introduction of the Carbon Border Adjustment Mechanism (CBAM), and to fully address the digital transition.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) Increasing funding and capacity for skills and training, social protection and healthcare to improve employability and social inclusion; (ii) Speeding up connectivity, green transition and adaptation to climate change; and (iii) Increasing competitiveness, notably by improving business support services, funding research and innovation, continuing to address informality and by implementing reforms relevant to the digital transition. In addition, the informal economy continues to impact the business environment and harm public revenue collection, which is particularly relevant for the post-pandemic recovery, therefore, though fiscalisation and other measures have had some impact, efforts to tackle the informal economy need to continue. It is also important to address land reform issues.

Despite increasing educational attainment, young people face difficult labour market transition pointing to issues with relevance and quality of the education system, and to a lack of attractive opportunities in the labour market, including relevant job offers, minimum and average wage levels, and decent work conditions. Albania started developing tools for regular monitoring of the labour market and of skills needs, the use of which can help to make the offer of initial and continuous vocational education and training more relevant to labour market needs. Albania has also developed a Youth Guarantee implementation plan to address the situation of young NEETs, and is preparing for piloting the scheme. The allowances paid under the Economic Aid scheme are not high enough to combat poverty, but the government took several measures to increase them, and started a process to review their adequacy. Social services availability is improving rapidly, but more services remain needed to enable active inclusion of vulnerable people. The state budget resources for the development of new social services have been increased, however close attention needs to be paid to the sustainability of the new services, especially in municipalities with lower resources. The healthcare system is underfinanced with a significant share of uninsured people. The government took multiple steps to increase healthcare coverage and access, including ensuring free healthcare for uninsured citizens, but access to healthcare and medicine continues to be limited, mainly due to high out-of-pocket payments. Social dialogue remains very weak in both the public and private sectors, and steps are needed to make it more effective and to bring it to higher levels of discussion and decision-making.

Participants welcome that Albania reached a milestone achievement in the publication of harmonised indices of consumer prices and made progress concerning the timeliness of excessive deficit procedure notifications and coverage of government finance statistics. However, significant progress is still needed in national accounts, including quarterly national accounts, regional accounts, and in international trade in goods statistics. Labour market statistics and short-term business statistics also need close attention.

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

1. Achieve as envisaged a non-negative primary balance in 2023 while providing targeted support to vulnerable households and firms if needed to cushion the impact of high energy prices and, thereafter, implement the medium-term budgetary plan aiming to reduce the public debt ratio and increase the primary surplus while using the regular revision process for budget amendments. Keep general government arrears in each quarter of 2023 at maximum 2.5% of total expenditure and below 2.4% of total expenditure at end-2023. Inform decisions about new state guarantees and on-lending to public entities by a systematic risk assessment.

2. Continue measures to increase tax revenue as share in GDP in a growth-friendly way while taking into account the results of a broad public consultation on tax policies. Complete procedures to fully establish the National Single Project Pipeline (NSPP) and advance the necessary legal amendments to fully integrate PPPs into the NSPP. Increase spending on education, social protection and health as a percent of total expenditure and issue instructions for data collection on public expenditure on R&D.

3. Continue to carefully assess and analyse price developments, including by publishing additional indicators of underlying price pressures, and ensure a sufficiently tight monetary policy stance to preserve price stability in the medium term, including by further tightening monetary policy, if needed. Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality, to further reduce obstacles to NPL resolution and to reduce data gaps in particular as regards the real estate sector. Continue the implementation of measures aimed at promoting saving and borrowing in domestic currency, limit unhedged lending and the use of foreign currency in the real economy, with all signatories of the Memorandum of Cooperation taking appropriate action.

4. Develop business support services to create a business environment to nurture SMEs' greening transition, further accelerate SME digitalisation and e-commerce, offer robust insolvency prevention policies to SMEs at risk, and ensure a coherent and predictable application of the property law. Enhance energy resilience and diversification towards green energy transition to implement the Green Agenda, notably the electricity, energy efficiency and climate *acquis.* Implement within 2024 the adopted climate and energy targets based on the National Energy and Climate Change Plans, as part of the 2030 decarbonisation roadmap, and ensure that the Renewable Energy Operator is operational by end 2023, in line with the renewables law that was adopted on 23/3/2023.

5. Encourage cooperation between innovative businesses research organisations, and academia, as foreseen in the Strategy on Business and Investment Development 2021-2027, by continuing to increase science and research funding, and by creating the conditions for the development of business incubation programmes. Conduct a Youth Guarantee pilot and analyse its performance, and in parallel review and adjust the functioning and operational structure of the National Agency for Employment and Skills (NAES) to accommodate the service delivery of the Youth Guarantee and develop a set of quality offers. Use the outputs of the Labour Market Observatory to improve the labour market relevance of vocational education and training (VET), invest in its quality and ensure cooperation with the private sector; focus on building skills of youth and adults, with a particular focus on digital skills to support the expanding communications and technology sector.

6. By 2024, establish a mechanism for the annual indexation of the 'Economic Aid' benefits to ensure their adequacy based on the assessment carried out. Ensure sustainability of the newly created services and encourage the creation of new services within the increase of the allocation to the National Social Fund, especially in the municipalities offering the least number of social services and with lower resources. Continue the cooperation with NAES on the 'Economic Aid' Exit Strategy to refer beneficiaries to the services offered by NAES, and in particular analyse and address the reasons for refusal to take on offers of employment or training.

Bosnia and Herzegovina

Bosnia and Herzegovina again submitted its Economic Reform Programme 2023-2025 with a very significant delay on 20 March 2023. This delay and weak compliance with ERP requirements have impeded a proper assessment of the policy plans to address the significant economic challenges the country is facing. The country's continued non-compliance with agreed procedures raises doubts about the commitment of stakeholders responsible for delays in the ERP's adoption and submission. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 24 May 2022 has been implemented to a limited extent.

After a strong post-pandemic growth rebound in 2021, a deteriorating international environment and increasing inflationary pressures led economic activity to decelerate during 2022, to an estimated 3.9%, largely driven by domestic demand. Russia's war of aggression against Ukraine is affecting the country primarily through indirect channels in the form of higher prices for imports and weaker external demand. The ERP expects economic growth to slow further in 2023 and to moderately accelerate in the medium term, to 3% in 2025, benefitting from an improving international outlook and strengthening domestic demand, in particular private and public investment. The labour market is projected to benefit from the strengthening economic activity. Despite a moderate, domestically-driven growth acceleration, the programme expects the current account deficit to decline, with appears optimistic. A key domestic downside risk to the economic outlook is a continued lack of reform momentum due to sustained political stalemates, which would impede investments. On the external side stronger-than-expected negative effects from Russia's invasion of Ukraine could dampen growth prospects.

After a better-than-expected revenue performance and a projected small budget surplus in 2022, the programme envisages a largely balanced budget in 2023 and significant fiscal surpluses in 2024 and 2025. The main contribution to fiscal consolidation is planned to come from increased revenues, while total expenditure is projected to remain largely unchanged as a percentage of GDP. On the revenue side, social contributions are expected to increase strongly, while on the spending side low overall growth of investment makes room for larger increases in social transfers. However, the ERP does not sufficiently explain the policy measures behind these projected changes. The planned reduction in investment spending in 2024 is in conflict with the macroeconomic assumptions and is not in line with the country's needs and the jointly adopted 2022 policy guidance. From 2024 onwards, significant primary surpluses are expected to reduce the debt ratio, to close to 28% of GDP by 2025. Key risks to the fiscal scenario are optimistic assumptions about revenue growth and insufficiently specified expenditure cuts. The reliability of the presented fiscal framework is impeded by a weak alignment with EU public sector accounting standards. The reporting on contingent liabilities, in particular in the area of public enterprises continues to be weak. As a result, both the deficit and debt ratio could be significantly higher than reported. Furthermore, the uncertainties related to the impact of Russia's war against Ukraine could require a longer than expected support to vulnerable households and firms. Overall, despite the relatively low level of public debt, the envisaged fiscal scenario does not appear to appropriately respond to the challenges the country is facing, in particular the moderate growth outlook, high investment needs and challenges related to progress towards EU accession.

Monetary policy has continued to be anchored around the currency board arrangement, which enjoys a high level of credibility with the general public and is a key ingredient of monetary stability, while implying limited scope to address inflationary pressure. Headline inflation, driven by food and energy items, has accelerated in 2022, reaching a peak in October at 17.4%. Since then inflation has decelerated, but is expected to return towards its historical average in 2024 only. The new board of the central bank still remains to be appointed, which is overdue since 2021, when the terms of current incumbents expired. The entity banking supervisory authorities continued to closely monitor the financial system in strong cooperation. They have effectively and swiftly resolved the Sberbank crisis. Overall, the banking sector appears sound and resilient. It enjoys robust capital buffers, high liquidity and profitability continued to improve. The quality of loan portfolios remained solid despite the full expiration of pandemic-related policy support. Downside risks to asset quality mainly result from the economic slowdown, high inflation and tighter global financial conditions. Removing remaining obstacles to an effective and swift non-performing loan (NPL) resolution, such as further enhancing the possibility to negotiate out-of-court restructurings or securitise and sell NPLs would be beneficial. The Sberbank case highlighted the need for a single resolution fund and for reviewing the framework for emergency liquidity assistance.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine in the year ahead the potential for maintaining economic resilience as well as boosting inclusive growth, competitiveness, jobs creation, while accelerating the transition to a greener and more digital economy for meeting increased external market pressures.

The recovery would also benefit from further efforts to tackle corruption and improve the rule of law, including by a swift introduction of a system of verification of asset declarations of judges and prosecutors and members of the High Judicial and Prosecutorial Council in line with European standards, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth remain (i) improving the business environment and strengthening the country's internal market and readiness for the green and digital transition, (ii) improving the performance, transparency and accountability of public enterprises, and (iii) increasing employment, particularly of young people, women and people in vulnerable situations. A difficult business environment and weaknesses in the country's single economic space are key factors driving poor labour market outcomes and holding back improvements in competitiveness and living standards and preparations for the green and digital transitions. Insufficient political ambition to tackle regulatory burdens and corruption and to face the challenges of the green and digital tranisitons remains an issue, but the country's high degree of institutional and regulatory fragmention and low level of coordination among all levels of government are also major obstacles. Key enabling legislation at the state-level related to open gas and electricity markets and targets for renewable energy and energy efficiency remain to be adopted to ensure the green transition and facilitate needed investments. Preparations should also be made for introduction of the Carbon Border Adjustment Mechanism (CBAM). Bosnia and Herzegovina is lagging behind in the digital transition and has unfortunately made little progress towards a harmonised, countrywide electronic identity and signature system. Public enterprise reform must be significantly stepped up, starting with enhancing oversight and transparency. A large share of the population is inactive and access to the labour market is especially challenging for young people, women and people in vulnerable situations. However, as labour market policy falls within the competence of the entities, it is necessary for the administration to come up with a solid and coherent countrywide diagnostic and to agree and implement the necessary strategies and reforms. High youth unemployment, even among university graduates, and the high share of young people not in employment, education or training point to a lack of alignment between education and training and labour market needs. The education system needs reforming to address skills mismatch, increase provision of early childhood education, and improve access for vulnerable groups to the education system. Bosnia and Herzegovina has committed to establish a Youth Guarantee scheme, but more active steps are needed to develop an implementation plan. Consultations with the social partners on the design and implementation of economic, employment and social policies are uneven across entities.

Participants welcome that Bosnia and Herzegovina made progress on national accounts by improving the timeliness of national accounts main aggregates and improving the length of time series for quarterly national accounts, on international trade statistics by improving the completeness of the transmitted data file and on labour market statistics by significantly improving the timeliness of Labour Force Survey (LFS) microdata in good quality. Progress in the areas of short-term business statistics and balance of payments was limited and Bosnia and Herzegovina has yet to provide data for harmonised indices of consumer prices (HICP) and regional accounts. While efforts should be pursued to improve the coverage and timeliness of almost all statistics, priority should be given to national accounts, excessive deficit procedure and government finance statistics. Bosnia and Herzegovina needs further alignment with the new requirements in short-term business statistics, as well as progress in the field of monetary and financial statistics.

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

1. Use the available fiscal space in the 2023 budget for targeted support to vulnerable households and firms if needed to cushion the impact of high energy prices. Increase the share of government capital spending in GDP by measures improving public investment management and an accelerated implementation of those investment projects that have been subject to a clear positive cost-benefit assessment. In order to improve the efficiency of tax collection, ensure an effective exchange of taxpayer information amongst the country's tax authorities, and in particular, clarify the constitutional competence for establishing a central (i.e. country-wide) registry of bank accounts of private individuals, in line with the EU acquis.

2. Prepare a report on contingent liabilities, and a strategy on how to contain the emergence of new contingent liabilities, in particular in publicly owned enterprises, and manage risks related to existing ones. Strengthen the analytical capacities of institutions responsible for fiscal accounting, in particular of the BiH Ministry of Finance and Treasury, of the Federation's Ministry of Finance and the Ministry of Finance of RS with a view to improving the quality of fiscal accounting including those required for the preparation of the ERP and improve the procedures for preparing the ERP in order to ensure a timely submission and compliance with the requirements. Continue to strengthen the country's capacities in the areas of macroeconomic statistics, regional accounts, labour force survey and government finance statistics, and increase efforts to improve the coverage and timeliness of all statistics.

3. Continue to carefully assess and analyse price developments, supported by the statistical offices through improving price statistics, including a timely publication of CPI weights and developing and publishing core inflation series. Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality, further reduce institutional and legal obstacles to NPL resolution, reduce data gaps in particular as regards the real estate sector and initiate setting up a single resolution fund. Safeguard the integrity of the currency board arrangement and the independence of the central bank, in particular appoint Governing Board members without further delay.

4. With a view to improving the business environment and preparing for integration into the single market, engage with work related to the second cluster, further simplify business registration, licensing and permitting procedures and harmonize them across the country with a view to digitalising them in the near future. Adopt the law on electronic identity and trust services for electronic transactions with a single supervisory body in line with the EU *acquis* and ensure that the Indirect Taxation Authority, whose ability to fulfil its vital country-wide role must be maintained, begins implementing the authorised economic operator (AEO) concept and starts preparations for joining the Common Transit Convention. Strengthen the governance of public enterprises by updating the registers in both entities to ensure they include all public enterprises together with comprehensive financial statements, audits and organizational information; allocate adequate human resources to the central oversight units in both entities; and prepare a report on the contingent liabilities related to public enterprises and a strategy to manage these fiscal risks.

5. In line with the Green Agenda for the Western Balkans and the Energy Community Treaty, adopt and begin implementing a single integrated energy and climate plan for lowering carbon emissions through increases in renewable energy and energy efficiency. Adopt State-level legislation for electricity and gas and ensure the full harmonization of laws at entity-level in these areas to prevent further delays in the opening and operating of the energy market and establishment of a day-ahead electricity market. Design and implement a comprehensive building renovation strategy at all levels of authority to improve energy efficiency and demand reduction measures, including required legislation and incentives for private sector and households.

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

Kosovo

Kosovo submitted its Economic Reform Programme 2023-2025 on 31 January 2023. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 24 May 2022 has been partially implemented.

Kosovo's economic rebound moderated significantly in 2022, with annual output growth easing to 3.5%, mainly due to a decline in investment and a deceleration of household consumption growth due to high inflationary pressures, especially after the start of the war in Ukraine. Economic activity was propelled by sizeable temporary government support to mitigate the impact of the energy crisis. The ERP's baseline scenario projects an average annual GDP growth of 6.1% in 2023-2025, which is above the historical trend. An expected strong rebound in investment is seen as a key growth driver, but in order to realise this ambition, obstacles to public investment execution need to be effectively addressed. There are additional sizeable downside risks to this outlook notably linked to higher-than-expected energy and food prices following Russia's invasion of Ukraine and the induced energy crisis, which could also lead to less dynamic trade developments with the main EU (and non-EU) trading partners. Further risks stem from tighter financial conditions and lower-than-expected financial inflows from the diaspora.

The programme projects the headline budget deficit to widen to 3.4% of GDP in 2023 in light of the planned strong fiscal stimulus, mainly through an investment and wage-driven increase in public spending, which would nonetheless keep the deficit according to the fiscal rule definition at the prescribed ceiling of 2% of GDP (since it excludes certain investment categories from the deficit). Compliance with the deficit ceiling as per the fiscal rule is also envisaged for 2024-25, with the shortfall projected to decrease to 1.1% of GDP in 2024, before turning to a marginal surplus of 0.1% in 2025. Due to the lack of sovereign rating, Kosovo lacks access to international credit markets and relies on domestic financing and funds provided by international donors. Fiscal risks, some of them included in the programme, stem from potential pressure for new social benefits and lower-than-expected revenues.

The envisaged compliance with the 2% deficit ceiling in 2023-25 needs to be underpinned by appropriate revenue and spending measures. Tax collection has recently been increasing by double digits mainly due to high inflation and fighting of informal economy. However, budget revenue relies on a narrow tax base, which is weakened by still high levels of informality, exemptions, preferential tax rates and special regimes. Public spending could improve further by better targeting social transfers and strenghening investment management. There is a need to reform the social security system and ensure that spending on war veteran pensions as well as public employees' salaries according to the new wage law comply with the prescribed legal ceilings. Public investment would benefit from comprehensive reforms to improve project planning and implementation. Fiscal risks related to publicly owned enterprises should be better monitored and included in the budgetary planning.

Consumer price inflation averaged 11.6% in 2022, markedly higher than the 3.3% rate registered in 2021, on the back of rising food, energy and transport prices. The banking sector remained sound and resilient according to headline figures at the aggregate level. Profitability has increased in nominal terms while both liquidity and capital buffers are robustly above their regulatory minima despite some weakening. Lending to the private sector continued to expand in 2022 mainly on the back of increased credit demand from corporates, also fuelled by government direct support for business loans, while credit conditions tightened slightly. Deposits were supported by diaspora inflows. The non-performing loan (NPL) ratio remained stable at a historically low level and loan provisioning is adequate. However, given downside risks amid the economic slowdown, persistent inflationary pressures and the tighter global financial conditions, banks' credit quality and liquidity should continue to be closely monitored. While the current system of private bailiffs appears to work well, structural problems to NPL resolution related to the rule of law and the efficiency of the court system persist. A still relatively low headcount in the central bank's core policy areas and important data gaps (in particular as regards real estate statistics) impede a comprehensive analysis and supervision of the financial sector.

The governments' determination and ability to tackle the identified structural challenges in a forthright manner, supported by the effective use and implementation of IPA, the Economic and Investment Plan for the Western Balkans and the Energy Support Package, will determine the potential for fostering economic resilience as well as boosting inclusive growth, competitiveness and accelerating the transition to a greener and more digital economy. Progress towards a more competitive economy is also contingent on further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue. As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term inclusive growth remain: (i) Improving energy security and sustainability by reforming the energy sector, transitioning to renewables and tapping energy saving potential; (ii) Improving the quality and relevance of the education system to increase employment and reduce skills mismatches; and (iii) Formalising the economy, improving the business environment and private sector competitiveness.

Unreliable and undiversified electricity supply and an extremely fragile energy sector remains a key bottleneck for Kosovo's economic development. Kosovo is particularly dependent on outdated, unreliable and highly polluting coal production sources. Kosovo also suffers from high distribution and technical losses due to poor infrastructure and insufficient incentives for adoption of energy efficiency solutions. Good progress has been made in preparing reforms in this area with the adoption of the energy strategy and the preparation of auctions for renewable energy projects but more progress is needed in terms of implementation including preparations for the introduction of the Carbon Border Adjustment Mechanism (CBAM). The development of the private sector including foreign direct investment flows would play a key role in the diversification of Kosovo's economy, and access for the workforce to adequate levels of social protection and training is important. Progress has been made in the area of fighting informal economy with the strategy and action plan on the informal economy, with notable increases in tax revenues due to increased formalization. Progress has also been made in preparing business environment reforms such as simplification and digitalisation of permits. However, a focus on implementation is now needed to achieve the reforms.

The economy mainly based on small and medium-sized enterprises and subsistence agriculture struggles to provide employment for the younger generation. The situation of women and minorities in the labour market is even less enviable. The education system at all levels is inadequate, of insufficient quality and needs to reduce the skills mismatches and facilitate the transition from school to work. The employment service needs to be modernised and strengthened rapidly to deliver the expected services. Adequate coordination of relevant reforms and initiatives by the authorities is essential to meet the challenge. To address these issues, authorities have initiated a number of important structural reforms. Facilitating access to pre-primary schools, including in rural areas, introduction of dual-education and the reform of the social protection system, modernisation of the employment services are among the initiatives being undertaken. In line with the Western Balkans Declaration on ensuring sustainable labour market integration of young people, the authorities are strongly committed to implementing the Youth Guarantee.

Participants take note that Kosovo reached a milestone achievement in the publication of harmonised indices of consumer prices. Progress was made concerning the transmission of national accounts, excessive deficit procedure, government finance and international trade in services statistics. However, data for several statistical domains such as short-term business statistics and research and development are still missing. Although progress was made in the timeliness and completeness of annual national accounts data, efforts should continue towards a complete set of annual and quarterly national accounts and government finance statistics.

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

1. 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. 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. Undertake and publish a comprehensive review of tax expenditure quantifying the size of the revenue forgone from all exemptions, preferential rates and special regimes.

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. Review the options paper on the establishment of an independent body for fiscal oversight and inform the Commission about the follow-up.

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. 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. 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.

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.

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. Continue to incentivise formalisation of employment and businesses and address tax evasion in identified high-risk sectors through better inter-institutional cooperation. Simplify the system of licenses and permits, and complete the restructuring of SME and investment promotion agencies and ensure adequate resources.

6. Develop a roadmap for the implementation of key reforms of the education system, including the recommendations under the ETF Rapid Education Diagnosis. 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. 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.

Montenegro

Montenegro submitted its Economic Reform Programme 2023-2025 on 25 January 2023. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 24 May 2022 has been implemented to a limited extent.

Helped by strong tourism exports and surging private consumption, Montenegro's economy expanded by double-digits in the first half of 2022 but started to decelerate in the later months of the year. The baseline scenario set out in the ERP projects real GDP growth to slow to an average of 4% in 2023-2025 and to be driven by a continued recovery in tourism, a strong increase in investment and decelerating but still positive private consumption growth. The balance of risks is tilted to the downside as domestic political instability and higher financing costs could negatively affect investment; slowing growth in trade partners could dampen tourism exports; while risks related to the fallout from Russia's war against Ukraine could result in further increases of energy and food prices, eroding disposable income. Imports may increase by more than expected if investment plans are realised.

Recent measures, including a decision to abolish health contributions, weakened the revenue base and, together with a number of new, mostly permanent increases in mandatory spending, resulted in a significant increase in the deficit target in the revised 2022 budget, to more than 8% of GDP. However, the actual outcome was lower at below 5% of GDP as high inflation and strong real growth boosted indirect revenue while spending on investment and wages was lower than budgeted. Absent any consolidation measures, the ERP projects the budget deficit at some 6% of GDP in 2023-2025, implying a pro-cyclical fiscal stance, and public debt to stabilise at a high level of close to 75% of GDP.

Debt repayment needs are set to increase sharply, especially in 2025, which, coupled with tightening financing conditions, raises vulnerabilities and calls for a more prudent fiscal position. Fiscal sustainability needs to be enhanced by a medium-term plan based on specific consolidation measures. Broadening the tax base, streamlining tax exemptions and incorporating new budget revenue initiatives to offset recent revenue-decreasing measures would contribute to rebuilding fiscal space and reducing public debt. Strengthening the long-term sustainability of public finances requires improvements in fiscal governance and public investment management. New expenditure initiatives have been adopted without properly assessing their fiscal implications. Large infrastructure projects need better management and prioritisation in light of the very limited fiscal space available. Following up on plans to set up an independent fiscal institution would contribute to strengthening fiscal governance and discipline.

Inflation has accelerated to reach a peak of 17.5% in November 2022, driven mainly by imported food price inflation, and has been slowly declining since then. Under the chosen monetary framework, limiting the scope to address inflationary pressure, fiscal restraint is essential to contain risks that inflation gets entrenched at elevated levels. The banking sector has remained sound. On the back of the economic recovery, key financial stability indicators improved. An influx of liquidity driven by deposits in 2022 also supported private credit growth. The banking system enjoys adequate capital buffers and profitability. It remains important to continue to strengthen the forward-looking monitoring of banks' asset quality and ensure sufficient provisioning, following the completion of the Asset Quality Review in 2021. The authorities have also made progress in financial sector reforms, including in advancing key legislations such as the Law on Credit Institutions and the Law on Resolution of Credit Institutions that align Montenegro's regulation and supervision with the EU framework. A more comprehensive assessment of risks is hampered by data availability, in particular as regards real estate statistics. Progress could be accelerated to strengthen the broad legal, judicial and regulatory framework, which requires inter-ministry collaboration outside the mandate of the central bank to expedite the resolution of non-performing loans.

Political stability and resolve will be decisive to maintain economic resilience, supported by the effective use of the IPA funds and implementation of the Economic and Investment Plan for the Western Balkans. It will also be critical to boost inclusive growth, increase competitiveness and job creation and accelerate the transition to a greener and more digital economy, while ensuring fiscal sustainability and working towards alignment with the EU acquis. This should be underpinned by intensified, substantial efforts to tackle structural reforms in key areas, including to address corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

The three specific structural reform areas in terms of boosting competitiveness and long-term and inclusive growth in Montenegro are: (i) strengthening the regulatory environment, (ii) reducing informality in the economy and (iii) increasing employment, in particular of women and young people and tackling long-term unemployment.

The authorities should focus on making the regulatory environment more business-oriented. This includes further fostering the digitalisation of public administration and developing e-government services, while stepping up the cybersecurity of the public IT infrastructure. The green transition, and preparation for the introduction of Carbon Border Adjustment Mechanism (CBAM), needs to be incorporated and mainstreamed by the government. There is an urgent need to reform the management framework and oversight of the State-Owned Enterprises in line with the best European practices to improve their performance and limit fiscal risks. Continuous dialogue and cooperation, involving state, local administration, businesses and civil society partners remains instrumental.

A clear vision, political lead and good cooperation between business, civil society organisations, social partners, state and local authorities is also needed to break the current pattern of nominal progress and erratic implementation of reforms aimed at reducing the size and scope of the informal economy. A comprehensive action plan to reduce informality is yet to be formulated and clear reforms and actions need to be prepared and implemented on its basis.

While with the economic recovery from the COVID-19 crisis the labour market indicators have improved and some are surpassing pre-crisis levels, persistently low activity and high unemployment rates, especially among women, young people and the low-skilled and high long-term unemployment remain a structural challenge. The rate of young people not in employment, education or training remains high and shows no sign of recovery from the crisis. Montenegro is expected to adopt the Youth Guarantee Implementation Plan to address the situation in early 2023. Skills mismatches remain an obstacle to transitioning into employment. The improvement of the effectiveness of active labour market measures, their monitoring and therefore evidence-based design, and effective delivery remain lacking. Coordination between employment and social services recorded limited progress and therefore disincentives to work persist. The progress in strengthening social dialogue seen in 2021 remains. Efforts of the government to improve the broader innovation ecosystem have taken a step forward with the establishment of the Innovation Fund.

Participants welcome that Montenegro reached a milestone achievement in the publication of harmonised indices of consumer prices. Data gaps remained in national accounts, R&D, labour market statistics, short-term business statistics and balance of payments. Montenegro needs further alignment with new requirements in short-term business statistics, and monetary and financial statistics need further attention. Montenegro should also give priority to the transmission of excessive deficit procedure (EDP) notifications and government finance statistics (GFS) as Eurostat is, at this stage, unable to assess their compliance given that no data is transmitted for GFS and very few data were transmitted for EDP in the past.

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

1. Adopt an appropriately tight fiscal stance in 2023 to help disinflation, while providing targeted support to vulnerable households and firms, if needed. Adopt a new medium-term fiscal strategy with the 2024 budget, including concrete consolidation measures supporting the achievement of a non-negative primary balance from 2025, and a reduction of the public debt ratio over the medium-term. Ensure proper costing of new fiscal initiatives before considering them for adoption.

2. Implement the public investment management assessment (PIMA) recommendations, prioritising key public infrastructure works within the available fiscal space while avoiding exceptions regarding project selection. Adopt the planned amendments to the Law on Budget and Fiscal Responsibility and take concrete steps towards setting up a fiscal council. Based on an analysis of the economic and fiscal impact of all tax expenditures to be shared with the Commission, prepare concrete budgetary recommendations to reduce tax expenditure (such as exemptions, deductions, credits, deferrals).

3. Continue to carefully assess and analyse price developments, stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality and continue to reduce data gaps in particular as regards the real estate sector. Continue to improve and implement legislations to further align with the EU framework on regulation and supervision, including on deposit insurance, and accelerate efforts to provide viable and timely solutions for swift and effective NPL resolution.

4. Improve the institutional and regulatory environment and enhance energy resilience and transition to implement the Green Agenda. Further digitalise and simplify administrative procedures for micro, small and medium enterprises and prioritise cybersecurity, data protection and business continuity for e-government services. Prepare a roadmap for reforming state-owned enterprises (SOEs), prepare a framework for the monitoring and management of SOEs and develop objective criteria for the selection of their management bodies.

5. Based on the results of the informal economy survey, establish an action plan to reduce informality. Ensure cooperation between central and local authorities to implement the plan, including prevention and incentives to legalise informal businesses and employees. Develop an analysis of the inspection services and of the relevant legal framework to optimise the inspector's work, minimising discretionary decisions and inconsistences in the inspection powers.

6. Prepare activities for the implementation of the Youth Guarantee pilot planned for 2025, analyse its performance, and in parallel identify and implement necessary structural, operational and organisational changes to ensure that the Employment Agency of Montenegro is prepared for the service delivery of the fully-fledged Youth Guarantee as well as its other functions. Continue efforts to reform the provision of active labour market policy measures with an emphasis on their labour market relevance, including work-based learning, and establish a continuous monitoring mechanism that will enable evidence-based active labour market policy design. Based on the Roadmap of reforms on social assistance and social and child protection services in Montenegro, establish a clear timeline and financial planning for the reform of the social and child protection system and start implementing the reforms.

North Macedonia

North Macedonia submitted its Economic Reform Programme 2023-2025 on 2 February 2023. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2022 has been partially implemented.

Following a strong post-pandemic recovery in 2021, the economy lost steam in 2022 and GDP growth dropped to 2.1% as domestic demand weakened. As North Macedonia is highly dependent on energy imports, the rise in global commodity prices led to a sharp deterioration in its current account balance. The ERP projects annual real GDP growth to gradually accelerate to an average 4% between 2023 and 2025, based on strengthening foreign demand and a large surge in investment, led by a marked increase in public capital expenditure, which seems somewhat optimistic in view of regular underspending and capacity constraints. Net exports are set to have a negative contribution to growth, yet in a gradually diminishing manner over the period. There are sizeable downward risks to the growth scenario, such as uncertainties related to the Russian war of aggression, energy and commodity prices, global financial market conditions; domestic pressures on inflation, such as high wage growth; as well as the noted large implementation risks with regard to private and public investment.

On the back of stronger than expected revenues amid high inflation, the budget deficit was lower than planned in 2022, at 4.5% of projected GDP, in spite of large-scale energy support. Between 2023 and 2025, the ERP projects fiscal consolidation to progress, with the general government deficit dropping to 2.9% of GDP in 2025. However, fiscal consolidation plans are back-loaded, postponing the return to the pre-pandemic primary balance to beyond 2025. The general government debt level is expected to remain below the 60% ceiling defined in the new Organic Budget Law (OBL) throughout the programme's horizon.

Given the need to restore fiscal space, consolidation could be brought forward, helped by further tax and governance reforms. Untargeted support measures should be gradually withdrawn. The 2022 tax proposals are an important first step towards increasing public revenue and the Government should continue with further revenue-enhancing measures, including broadening of the tax base. To ensure efficient implementation of budgeted capital expenditure, the management of public investment (PIM) needs to be improved, notably by making the new PIM department in the Ministry of Finance operational. The provisions of the new OBL should be swiftly implemented, in particular the fiscal rules, and the fiscal council should be enabled to take up operations in the course of 2023.

Inflation accelerated to reach a peak of 19.8% in October 2022 and has been declining since then. The rise in inflation mainly reflects global factors, particularly given the high weight of food and energy in the consumption basket. The increased uncertainty, caused by the external shocks, exerted some pressures for currency substitution that started to reverse at the end of 2022. Monetary policy has been appropriately tightened, and continued vigilance remains key going forward, also in view of a wide, albeit narrowing inflation differential with the euro area. Banking sector indicators on capital adequacy, liquidity and profitability remained sound despite the phasing out of pandemic-related support measures and the stress from the energy crisis. Non-performing loans (NPLs) remain at manageable levels, but the significant increase in energy and other import prices present an additional risk for corporates. Furthermore, building on the improvements in financial sector legislation, notably the passage of the Financial Stability Law, the authorities should further progress in alignment with EU laws and reforms to the broad legal, judicial and regulatory framework to expedite NPL resolution. While counter-cyclical buffers are being raised, the central bank may implement further macroprudential measures if necessary to address potentially rising risks in real estate sector lending. Further measures to address the recent reversal in denarisation trends would warrant consideration. Central bank independence should be preserved, including on staffing issues by excluding the central bank from the law on administrative servants and the law on public sector employees, as well as new related laws that may affect its autonomy in setting staff wages.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine in the year ahead the potential for maintaining economic resilience as well as boosting inclusive growth, competitiveness, jobs creation, while accelerating the transition to a greener and more digital economy for meeting increased external market pressures. The Commission has also proposed up to € 100 million in macro-financial assistance which will contribute to covering the country's financing needs and further incentivise moving forward with a comprehensive set of policy reforms to address the country's challenges.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) improving the quality and relevance of the education system to increase employment and mitigate skills mismatches; (ii) improving the competitiveness of domestic companies, including digital transition, integration into global value chains (GVCs) and reducing the informal economy; and (iii) energy sector modernisation and transition to clean energy. Competitiveness of domestic companies, investment and global value chain integration is undermined by a challenging business environment. This includes a large size of the informal economy, a lack of skills, lagging innovation and technology adoption, a complex legal and regulatory environment, low productivity and the need to reinforce the commitment to digital transition. The economic fallout of the pandemic and of Russia's invasion of Ukraine, including high energy prices, combined with supply-chain disruptions, have exacerbated these structural challenges. Fostering a sustainable recovery in the medium term, improving the competitiveness of local companies and benefiting from the post-crisis restructuring of global value chains requires an acceleration of structural reforms in these areas. The Russian aggression against Ukraine and the energy crisis clearly demonstrate that the green transition is the country's best chance to reduce vulnerability to external shocks and to become more energy independent. A clean energy transition will help lower energy prices over time and reduce import dependency, but entails significantly improving energy efficiency, promoting the distribution of less polluting energy production sources and investing in renewable energy sources. Energy transition and the sustainability of the energy system are priorities identified by the country, but implementation, including preparation for the introduction of the Carbon Border Adjustment Mechanism (CBAM), is challenging and needs to be accompanied by enhanced coordination and institutional capacity.

Education outcomes often do not meet the needs of the labour market. This contributes to persistent unemployment and a high share of young people not in employment, education or training. Youth Guarantee has been implemented countrywide to partly address the situation, yet the reform of education is a primary concern to improve employability. North Macedonia has drafted a new law on vocational education and training (VET) and a law on adult education that have yet to be adopted in the Parliament. In addition, North Macedonia plans to develop recommendations for improving the financing of higher education. The Government developed an activation plan for Guaranteed Minimum Assistance (GMA) beneficiaries for the period 2023-2025 with particular focus on youth and other groups facing difficulties to be employed. Enhancing the cooperation between the Employment agencies and social work centres is imperative in order to provide better services to the population in the field of social protection and to maximize the efficiency of the resources. Bipartite social dialogue in the private sector remains weak and the tripartite consultations need to be stepped up.

Participants take note that North Macedonia made some progress concerning annual and quarterly national accounts, although issues of timeliness and completeness remain in the area of both national and regional accounts. Gaps remain also in the areas of international trade in services, R&D, labour market statistics and short-term business statistics. Progress regarding adherence to excessive deficit procedure (EDP) methodology and completeness of EDP and government finance statistics data needs to resume. North Macedonia also needs to align with the new requirements in short-term business statistics.

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

1. Continue to provide targeted and temporary support to vulnerable households and firms to cushion the impact of the energy crisis, if needed, and at the same time start to phase out untargeted subsidies to the energy sector. Use any revenue overperformance or spending under-execution compared to the 2023 budget to reduce the deficit. Foresee in the medium-term fiscal plan accompanying the 2024 budget a gradual reduction of the primary deficit-to-GDP ratio to its pre-crisis (2019) level by the end of the ERP period.

2. Accelerate the implementation of the Public Investment Management Action Plan, in particular by ensuring the new Department for Public Investment Management in the Ministry of Finance becomes fully staffed and operational, and submit the new public-private partnership (PPP) law and the Law on concessions of goods of general interest to the Parliament for adoption. Adopt and submit to the parliament the next set of revenue-enhancing measures, as announced by the Concept for Tax Policy Reforms. Take the necessary legislative and organisational steps to enable the new Fiscal Council to take up operations with regard to the 2024 budget and the new fiscal strategy, in particular by swift appointment of its three members and provision of premises and administrative services.

3. Continue to carefully assess and analyse price developments and ensure a sufficiently tight monetary policy stance to preserve price stability in the medium term, including by further tightening monetary policy, if needed. Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality, further reduce institutional and legal obstacles to swift and effective NPL resolution, continue to reduce data gaps in particular as regards the real estate sector and further implement measures to promote the role of the domestic currency, involving all relevant stakeholders. Safeguard the National bank's independence in its key statutory tasks, including in staffing and wage issues, by adopting the amended law on the National bank, and excluding the National bank from the scope of all related laws on administrative servants and public sector employees.

4. Adopt and commence with the implementation of the new Strategy for formalizing the informal economy 2023-2025, with an action plan and ensure high-level political commitment. Adopt and start implementing the Export Promotion Strategy and Smart Specialisation Strategy/Action Plan to enhance competitiveness and integration in global value chains of domestic companies. Continue the digitalisation of public services for businesses and citizens by upgrading the e-portal for services.

5. To enhance energy resilience and transition towards implementing the Green Agenda, re-organise and strengthen state institutions dealing with energy policy and in particular increase the technical/engineering capacity of the Energy Department in the Ministry of Economy and the Energy Agency. Adopt the law on biofuels, secondary legislation to the energy efficiency law, the long term buildings renovation strategy and the legal and regulatory framework for the establishment of the Energy Efficiency Fund as well as establish a Renewable Energy Guarantee of Origin scheme. Establish a governance mechanism for Just Transition from Coal, including an operational Inter-ministerial Committee with involvement of local actors.

6. Finalise the new Law on vocational education and training (VET), Law on secondary education and the Law on adult education as well as provide a yearly report for improving higher education, including recommendations for a new formula for the financing of higher education. Building on the steps taken, strengthen access to active labour market policies, in particular for low-skilled unemployed and people in vulnerable situations. Continue to increase the capacity of and cooperation between the employment agencies and centres for social work as well as education and training institutions to provide integrated services and measures for improvement of inclusion in the labour market.

Serbia

Serbia submitted its Economic Reform Programme 2023-2025 on 31 January 2023. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 24 May 2022 has been partially implemented.

Impacted by the economic fallout of Russia's war against Ukraine, the Serbian economy slowed substantially in 2022. The ERP's baseline scenario projects economic growth to remain moderate at 2.5% in 2023, and to gradually pick up thereafter to 3.5% in 2024 and to 4.0% in 2025, thereby broadly returning to the pre-pandemic growth rates. As a result of high energy import costs and production outages at the domestic electricity utility, the current account deficit increased sharply in 2022 and is projected to stay above 5% of GDP throughout 2023-2025. In a context of continued high uncertainty, the growth outlook is, as elsewhere, subject to a series of downside risks associated with Russia's war of aggression against Ukraine and related geopolitical tensions, such as further fluctuations of energy prices and global trade restrictions, but also supply chain disruptions, persistent high global inflation and further tightening of financial conditions.

The general government budget deficit fell to 3.1% of GDP in 2022 as high fiscal support to state-owned energy utilities and a series of ad-hoc expenditure measures were offset by the balance-improving effects of high inflation. The 2023 budget targets a moderate further reduction of the deficit, helped by lower energy support measures. The ERP's fiscal scenario projects further expenditure-based consolidation to bring the budget balance in compliance with the new deficit rule applicable from 2025 that stipulates a maximum deficit of 1.5% of GDP if general government debt is between 45% and 55% of GDP. The debt-to-GDP ratio decreased to 55.6% in 2022 and is projected to continue declining gradually in 2023-2025. Keeping an appropriately tight fiscal stance in 2023 and planning a further gradual reduction in the deficit in the 2024 budget and medium-term fiscal framework in line with the SBA commitments and the new fiscal rules is key to supporting a return of inflation to target and rebuilding fiscal space. To reinforce the medium-term sustainability of public finances, remaining gaps in fiscal governance need to be addressed, in particular as regards the governance of state-owned enterprises (SOEs), transparency on fiscal risks, in particular those related to SOEs, and the reform of the public-sector wage system. Further strengthening revenue administration and medium-term budgeting would also contribute to enhancing medium-term policy credibility.

Faced with mounting inflationary pressures, the National Bank of Serbia (NBS) appropriately tightened monetary policy. Starting in autumn 2021 with tightening liquidity conditions and increasing sequentially its average reverse repo rate, from April 2022 the NBS continuously increased its key policy rate in monthly steps of 50 or 25 bps to 6.0% in April 2023, from 1% during the pandemic. Monetary tightening was transmitted to financial conditions, moderating lending growth and containing inflation. Headline inflation stood at 11.9% on average in 2022 and has reached 16.1% in February 2023. The NBS expects inflation to return within the tolerance band of 3% ±1.5 pps towards mid-2024. The NBS intervened in the foreign exchange market to maintain the relative stability of the exchange rate, initially selling foreign currency amid depreciation pressures and later buying it, overall accumulating reserves in 2022 (NBS bought net EUR 1 bln in FX interventions). The banking system remained resilient with sound indicators on solvency, liquidity and profitability. The full expiration of pandemic-related support did not impact asset quality, with the non-performing loan ratio continuing to decrease. Risks related to the real estate market are carefully monitored, also thanks to the recent publication of new real estate statistics. The resolution framework for non-performing loans still has margins for improvement by removing remaining structural obstacles. The trend of increasing dinarisation was interrupted temporarily after Russia's war of aggression against Ukraine started in the circumstances of heightened global uncertainty. While authorities are committed to further increase dinarisation, currency substitution remains high and continues to represent a potential financial stability risk through indirect credit risk and limits monetary policy choices.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine in the year ahead the potential for maintaining economic resilience as well as boosting inclusive growth, competitiveness, jobs creation, while accelerating the transition to a greener and more digital economy for meeting increased external market pressures.

This should be underpinned by further efforts to effectively implement structural reforms in key areas, including addressing corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue. The three specific structural reform areas in terms of boosting competitiveness and long-term and inclusive growth are: (i) creating a more favourable business environment for investment; (ii) greening Serbia's energy sector and fully opening the energy market; and (iii) increasing employment, in particular of young people, women and vulnerable groups, further invest in VET and other education and by substantially increasing social protection against poverty.

Privatisation efforts and measures to improve the management of state-owned enterprises should be accelerated, as the role of the state in the economy remains widespread. A certain share of public funds for capital investment continues to be spent without sufficient transparency and proper checks to ensure compliance with public procurement, state aid and technical standards, particularly when it comes to big infrastructure projects financed by third-country loans. There is a need to strengthen the implementation of the legal framework in the fields of competition and state aid. Business predictability should be further improved by ensuring full transparency in the adoption of legislation. Serbia remains highly dependent on coal and needs to adopt in the course of 2023 the coherent long-term strategy that combines energy and climate targets. Major investments are still needed to modernise energy infrastructure and lower carbon emissions with a view to the green transition as well as in order to limit the impact of the upcoming EU Carbon Border Adjustment Mechanism (CBAM) on Serbian key exporting sectors and economic integration with the EU. Further and heavily accelerated efforts are necessary to diversify supply and Serbia's overall energy mix notably to reduce excessive dependence on gas from individual countries.

Participants welcome that Serbia has reached a good level of compliance in most statistical areas. However, some datasets in national accounts are still flagged as confidential and further efforts are needed to achieve the full implementation of the ESA 2010 transmission programme. The Maastricht debt table is published regularly on a national level and some progress was made in the area of government finance statistics and in the area of the excessive deficit procedure data completeness, but most data is still flagged not publishable. Serbia needs to address missing data series in the area of national accounts, labour market statistics, short-term business statistics and GFS and further progress in the alignment with the new requirements in short-term business statistics.

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

1. Keep an appropriately tight fiscal stance in 2023 to help disinflation, including by reducing budget support to energy SOEs, while providing targeted and temporary support to vulnerable households and companies if needed to cushion the impact of high energy prices; and plan a further gradual reduction in the deficit in the 2024 budget and in the medium-term fiscal framework in line with the SBA commitments and the new fiscal rules. Contain overall spending on wages as a percentage of GDP in line with the new fiscal rule and continue the preparatory steps towards an appropriately designed public sector wage system reform. Strengthen medium-term budgeting via the development of a corresponding time-bound action plan and the implementation of its first steps.

2. Implement the tax administration reform according to the ERP 2023 timeline. Reinforce fiscal risk analysis capacity, in particular on SOEs, and make the resulting reporting publicly available in the fiscal strategy updates in spring and autumn. Continue the deployment of the SOE ownership and management strategy 2021-2027 by implementing the remaining steps of the time-bound action plan 2021-2023 and preparing the new time-bound action plan for 2024-2027 to improve the governance of SOEs and reduce related fiscal risks.

3. Continue to carefully assess and analyse price developments and ensure a sufficiently tight monetary policy stance to preserve price stability in the medium term, including by further tightening monetary policy, if needed. Strengthen further the reporting and risk management frameworks across the banking system as well as an accurate reporting of asset quality, further upgrade NPL resolution by reducing obstacles in the judiciary, improving bankruptcy procedures and facilitating out-of-court settlement, and building on recent progress further reduce remaining data gaps in particular as regards the real estate sector. Continue efforts to promote the use of the domestic currency, including by enhancing long-term financing in domestic currency, further encouraging forex hedging and raising awareness of risks related to forex lending.

4. Further improve transparency in the adoption and implementation of legislation, particularly by ensuring a timely consultation of businesses and social partners on new legislation affecting their operations, including on temporary legislative acts impacting established supply-chains of importing or exporting companies. Continue to ensure a harmonised approach for prioritising and monitoring all investments and basing investment decisions on feasibility studies, cost-benefit analysis and environmental impact assessments. Apply competition, equal treatment, non-discrimination and transparency principles in public procurement and state aid procedures in line with the EU acquis for all public investment projects regardless of the financing source and to ensure a consistent and transparent track record demonstrating the operational independence of the Commission for State Aid Control.

5. Adopt the national energy and climate plan in line with the Green Agenda for the Western Balkans and international commitments. Further modernise energy infrastructure and lower carbon emissions to accelerate the green transition also in the light of the upcoming EU Carbon Border Adjustment Mechanism (CBAM). Reduce over dependence from individual countries, accelerate renewables and energy efficiency, including launching first auctions for renewable energy sources (RES), further developing the administrative entity for energy efficiency, and the sustainability of the financing mechanism. Continue to implement the price and tariff reform, as well as other reforms related to energy SOEs, in line with Serbia's commitments under the stand-by arrangement agreed with the IMF in December 2022. To further liberalise the energy market, accelerate the unbundling of all energy utilities in line with the EU acquis and, for the gas sector in line with Serbia's Action Plan; as regards Gastrans, ensure that the regulatory regime is in compliance with EU acquis and the Action plan developed for the opening in December 2021 of Cluster 4 for Energy, Climate and Transport in the EU accession negotiations.

6. Reduce poverty by substantially increasing the adequacy of benefits of the Financial Social Assistance (FSA) scheme for individuals and families with children and by increasing the untaxable wage base close or equal to the level of the minimum salary for workers. Continue facilitating school-to-work transitions by stepping up further VET, including dual VET, through revised curricula and the provision of infrastructure, which enables the acquisition of practical skills. Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation.

Türkiye

In line with the current Economic Reform Programme (ERP) cycle, Türkiye submitted its Economic Reform Programme 2023-2025 on 31 January 2023, before the two devastating earthquakes that hit the country on 6 February, causing a tragic loss of life and significant destruction of capital assets. The earthquakes of 6 February 2023 represent, first and foremost, a very large humanitarian crisis. From an economic standpoint, the full impact of the earthquakes is yet to be assessed. A preliminary damage assessment, which covered 11 of the 17 provinces declared as earthquake-stricken zones (accounting for around 16.5% of Türkiye's overall population and around 10% of GDP), estimated the direct cost of the disaster at USD 103.6 billion. This figure may be revised upward as a result of further, more detailed assessment.

As such, this year's ERP assessment, which is based on a set of assumptions preceding these events, would need to be read in conjunction with Türkiye's revised priorities. This year's assessment should be read in the constructive spirit of cooperation with Türkiye, which represents the bedrock of the ERP.

Against this background, the implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2022 has been limited.

Overall, finding the right balance between pursuing economic growth, bringing down the very high inflation towards the target, reducing external imbalances, keeping exchange rate risks in check and maintaining policy buffers remains the key challenge. While there was a slowdown in the second half of the year, real GDP grew strongly by 5.6% in 2022. The ERP expects a relatively robust growth performance but, in view of the rising imbalances, its projections appear optimistic also in view of the extent of economic damage of the 6 February earthquakes. The trade deficit declined in recent years thanks to the outstanding export performance, but remained large and expanded last year as gold imports tripled and high energy prices doubled the value of energy imports.

The budget execution was better than expected and the budget deficit fell to below 1% of GDP in 2022. Following a strong fiscal impulse expected in the election year 2023, the ERP targets a mild fiscal consolidation over the medium term. Earthquake-related reconstruction will likely add to public spending pressures, even though the authorities' initial response was to try to accommodate such costs within the 2023 budget by using reserves and reprioritising expenditures. As the general government debt-to-GDP ratio came out better than expected last year, falling to 32% of GDP, Türkiye has some fiscal space to manage public finance risks, which have increased in recent years. Heavy-handed regulatory measures affected the government securities market but did not fundamentally address debt vulnerabilities. Most of the debt stock remains denominated in foreign currencies and the country risk premium is very high. Efforts to keep macro-financial risks in check also triggered the adoption of numerous ad hoc measures with budgetary effects leading to strains in public finance management. Fiscal governance would benefit from the introduction of fiscal rules and the setting up of an independent oversight body.

According to the CBRT, the main role of interest rates in its policy framework is to provide supportive financial conditions for the potential supply, particularly through the cost of financing for firms' investment and exports, and other measures were taken to improve the transmission of the policy rate to the targeted areas. This implied that interest rates were lowered despite very high headline and core inflation. A first easing cycle in late 2021 was followed by exchange rate volatility and significant depreciation. In addition to interventions in the forex market, depreciation pressures were contained by the introduction of FX-protected deposits by the Central Bank of the Republic of Türkiye (CBRT) and the Ministry of Treasury and Finance. The CBRT reduced interest rates further by 500bps in a four-stage easing cycle to 9% in November 2022, followed by another cut of 50bps in February 2023 in response to the earthquakes of 6 February 2023. Real interest rates are deeply negative, also in international comparison. Inflation increased in 2022, reaching a peak in October at 85.5%, before falling to 50.5% in March 2023. Lending rates increased due to increased demand for commercial loans following an increase in import prices. In order to lower commercial loan rates to improve monetary policy transmission, allocate credits towards priority sectors and limit the use of loans in forex, the CBRT and the Banking Regulation and Supervision Agency introduced a wide range of macroprudential, regulatory and capital flow measures. They aimed at supporting the investment and export capacity and reducing currency substitution in the context of the CBRT's new liraisation strategy. Inflation expectations are still significantly higher than the medium-term and the interim targets with the risk of inflation becoming entrenched at very high levels, although significant improvement started in the second half of 2022. Concerns remain among market participants over central bank independence. After a comprehensive evaluation of monetary policy tools, the CBRT introduced an integrated policy framework and considers the interest rate is the main instrument complemented by targeted loan, liquidity management, diversified reserve strategy and liraization measures. As a result, the operational framework has become more complex than before the introduction of the liraisation strategy, which aims at supporting the disinflation process. The banking sector has shown resilience with adequate capitalisation and low non-performing loan ratios, and performs well in international comparison to date. With regulatory forebearance potentially limiting comparability and the assessment of risks and new measures having added to the complexity of the regulatory framework, the overall effects of the policy framework is to be seen and assessed in the medium term.

The Turkish economy has shown a remarkable resilience during the recent years. Nevertheless, Türkiye is exposed to the fallout of Russia's invasion of Ukraine, notably – among other factors – because the country's dependency on natural gas imports from Russia is still significant. However, particularly after the surge in energy prices in 2022, efforts have continued to reduce energy import-dependency and to increase energy efficiency, with a view to deal with highly volatile international markets. The long-term economic impacts of both the aftermath of the COVID-19 pandemic, as well as Russia's war against Ukraine, make it all the more necessary and urgent to address the structural challenges confronting the Turkish economy. The main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) improve transparency, predictability and fair competition in the regulatory and institutional environment affecting businesses; (ii) setting up a credible and concrete roadmap to implement the ambitious net zero emission target by 2053; and (iii) raising the level of skills and increasing employment, in particular of women and young people.

The timely implementation of the reforms announced by the government against well-defined targets will play a pivotal role in the government's policy response for shaping the economy in this new context and to maximise investments, which are especially needed to also be able to tackle the socio-economic consequences of the earthquakes. In light of higher risk indicators and an ever more uncertain geopolitical environment, improving the investment climate will require efforts to improve the rule of law and effective competition, enhance transparency and predictability, and strengthen the independence of regulatory authorities. Moreover, these policies will contribute to maximise the benefits of the EU-Türkiye long-standing relations. Designing and implementing structural reforms to improve the investment climate and to reach carbon neutrality will require good governance, coordination and inclusiveness. The green transition, and preparation for the introduction of the Cross Border Adjustment Mechanism (CBAM), needs to be incorporated and mainstreamed by the government. The labour market has shown a good performance, with an improving employment rate and decreasing unemployment rates. The share of young people not in employment, education or training has declined, but continues to be very high and is coupled with high skills mismatches in the labour market. This should be addressed as a matter of priority. Despite some improvements, the female labour market participation remains structurally low and continues to be an impediment for further growth. Lifelong learning measures remain key to master the green and digital transitions of the labour market. Social dialogue remains marginal, considering its potential for employment and social policy.

Participants take note that Türkiye has improved compliance with respect to annual national accounts as regards timeliness but data gaps still exist both for annual and quarterly national accounts and some series are flagged not publishable. Türkiye should give priority to the timeliness and completeness of the transmission of excessive deficit procedure notifications and government finance statistics. Türkiye needs to make improvements in the area of international trade in services, labour market statistics, and balance of payments and to align with the new requirements in short-term business statistics.

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

1. Keep an appropriately tight fiscal stance in 2023 to help disinflation, including by reducing budget support to state-owned enterprises in the energy sector in view of the prevailing international energy prices, while providing timely and transparent support to alleviating the consequences of the February earthquakes. Present a credible medium-term strategy to support the envisaged gradual return to a primary surplus of at least 1% of GDP. Expand the tax base by streamlining tax exemptions and reductions.

2. Reduce fiscal risks by – *inter alia* – gradually phasing out the FX value guarantees on lira time deposits. Revise public procurement legislation to further align it with the 2014 EU Directives on public procurement, including utilities, concessions and public private partnerships and reduce the number of exemptions that are incompatible with the EU *acquis*. Prepare an options paper for the possible adoption of a fiscal rule and the setting up of an independent body to monitor its implementation.

3. Use all tools of the central bank, including interest rates, more decisively in order to accelerate the disinflation process and bring financial conditions in line with achieving price stability over the medium term and central bank independence. Provide more guidance and efficient communication with regards to policy tools as well as the evaluations of their potential effects, and increase the efficiency of the operational framework. Improve the transparency and predictability of the financial sector regulatory framework by aligning it with international and EU standards, and enhance confidence by conducting transparent asset quality reviews and publish its methodology and outcomes.

4. With the aim to improving business environment, further strengthen the rule of law and, improve the regulatory environment and consultation mechanisms with business organisations and social partners on relevant new legislation. Implement legislation and enhance transparency regarding State aid to maximise the benefit of the EU-Türkiye economic and trade relationship, as well as to achieve a meaningful level-playing field. Increase the number and improve the efficiency of specialised courts for business, with a view of streamlining commercial disputes.

5. Take further steps to implement the ETS carbon pricing mechanism. Continue to ensure the steady growth of renewables (both traditional and hydrogen-based) in Türkiye's energy mix and reflect this objective in the country's subsidies policy. Prioritise energy efficiency for new and existing buildings in order to adapt to climate change, especially in light of the reconstruction efforts that will follow the devastating earthquakes of 6 February 2023.

6. Support the school-to-work transitions and the activation of young people who are not in education, employment or training (NEET) and incentivise female labour market participation through legislative and fiscal measures, as well as through strengthened efforts on the provision of appropriate and affordable childcare infrastructure beyond the big urban centres of Türkiye. Support investments in the care economy in the provinces affected by the Earthquakes in order to provide victims with health and care services and create employment intensive opportunities, in particular for women. Continue increasing the participation of adults in lifelong learning, in particular to reinforce green and digital skills, in order to ensure just transition.