



Council of the
European Union

Brussels, 24 May 2022
(OR. en)

9459/22

ECOFIN 497
UEM 130
COWEB 52
ELARG 42

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 Turkey

Delegations will find attached the text of the Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey as approved by the participants of the Dialogue on 24 May 2022.

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

The Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, Brussels, 24 May 2022

Representatives of the EU Member States, the Western Balkans and Turkey, the European Commission and the European Central Bank, as well as representatives of the central banks of the Western Balkans and Turkey¹ met for their annual economic policy dialogue. The dialogue aims to prepare the Western Balkans and Turkey for their future participation in the European Semester.

The COVID-19 pandemic and the economic impact of Russia's war of aggression against Ukraine have confronted EU Member States, the Western Balkans and Turkey with major public health, 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 to the recent adverse shocks. Participants emphasised the strong common position by the EU and the Western Balkans and Turkey in deploring in the strongest terms the military aggression by the Russian Federation against Ukraine. In view of high uncertainty about potential further pandemic effects and the 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 until a self-sustained recovery is firmly established. Confronted with growing instability, strategic competition and security threats, the EU has decided to take more responsibility for its security and take 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 Turkey and recommitted to the economic and financial dialogue as it contributes to the wider goals of good governance, including rule of law, and economic prosperity. In order to build up economic resilience in the longer term, all participants committed to accelerating the green and digital transition of the Western Balkans and Turkey, including through the appropriate use of EU financial support through the Instrument for Pre-accession and the European Fund for Sustainable Development Plus.

Looking beyond the current crisis, participants agreed that the economic policy dialogue should continue to play a central role in providing jointly agreed policy guidance to support a medium-term sustainable 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 Turkey to implement macro-fiscal and structural policies and reforms as outlined in their programmes to foster a strong recovery. Participants emphasised that strong ownership will be key to a successful implementation of the jointly agreed policy guidance. Participants took note that, due to the Economic Reform Programme submission deadline of 31 January, the effects of Russia's war against Ukraine are not taken into account in the baseline scenarios. Participants regretted that Bosnia and Herzegovina's Economic Reform Programme had been submitted with a significant delay. The dialogue will continue in 2023, including on the implementation of these conclusions.

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

The Republic of Albania

Albania submitted its Economic Reform Programme 2022-2024 on 31 January 2022. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been partially implemented.

The economic rebound in 2021 was stronger than expected with real growth of 8.3%, and the ERP's baseline projects annual economic growth to stabilise at an average of 4% in 2022-2024, based on rising investment and private consumption and supported by net exports. There are downside risks to this projection from the impact of Russia's invasion of Ukraine, in particular from higher energy and food prices, less dynamic external trade with EU and non-EU trading partners and potentially tightening financial conditions. Solid employment growth is forecast to gradually lower the unemployment rate to below 10% by 2023. The fiscal deficit in 2021 turned out 2.3pps lower than planned, at 4.5% of GDP, because of strong revenue growth, underspending of the capital budget and a substantially higher nominal GDP than projected. The debt-to-GDP ratio slightly decreased to 73.2% of GDP at end-2021 from the peak of 74.5% at end-2020, including a Eurobond issuance to pre-finance the 2022 budget balance, and additional public guarantees for the state-owned electricity distributor to keep the administered electricity prices stable. The programme's fiscal scenario targets fiscal consolidation and moderate debt reduction from 2023 onwards, one year later than planned in the previous ERP. A rising revenue ratio together with lower investment expenditure, following the end of post-earthquake reconstruction, is expected to bring the deficit below 3% in 2023 and the primary balance into surplus as from 2024. This is projected to help lower the debt ratio by 4.4 pps. between 2021 and 2024, although still leaving it significantly higher than its pre-crisis level.

In view of high uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide targeted and temporary support to vulnerable households and firms if needed would be appropriate. Contingent on economic developments and outlook, gradually lowering the public debt ratio and honouring the new positive primary balance rule from 2024 while reducing government arrears would be key to rebuilding fiscal space. Improving the fiscal position while addressing spending needs should be underpinned by increased revenue mobilisation through the steadfast implementation of the medium-term revenue strategy (MTRS). The reliability of fiscal policy would benefit from the use of the regular legislative process for budget revisions and for any amendment of the budget law. Public infrastructure investment is envisaged to remain above pre-crisis levels even after the completion of reconstruction works following the 2019 earthquake. To this end, it is important to implement the long-standing recommendations to improve and harmonise public investment planning and management. Public expenditure would benefit from a more growth-friendly composition through complementing infrastructure investment with increased spending on human capital and research, for which allocations remain low.

The monetary policy stance has been appropriately accommodative, as inflation remained below target for most of 2021 and inflation expectations are well anchored. Inflation started to increase towards the end of the year on the back of high global energy and food prices, with pressures recently broadening, and the central bank in its forward guidance signalled its readiness to react, if needed. It has also resumed pre-announced purchases of forex reserves, further strengthening Albania's strong external buffers. The banking sector remained stable, well-capitalised and liquid, and profitability improved. Loan moratoria and forbearance measures were withdrawn timely with no visible impact on asset quality or credit flows, which increased significantly. The NPL ratio has declined but remains one of the highest in the region, while lagged impacts of the pandemic are being closely monitored. A comprehensive assessment of risks is hampered by data availability, in particular as regards real estate statistics. There has only been limited progress on removing

remaining obstacles to NPL resolution, particularly the bailiff impasse, which continues to delay collateral execution. The high level of currency substitution has slightly increased and, besides impeding the transmission of monetary policy, remains a latent risk to financial stability. While some progress was made in developing the market for hedging instruments, there are no plans for the introduction of measures to promote the national currency in the realm of the government.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by the effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine the potential for fostering post-pandemic recovery and economic resilience as well as boosting inclusive growth, competitiveness and accelerating the transition to a greener and more digital economy.

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 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) improving the business environment and investment climate by increasing the pace of reforms and government support, and by tackling informality; (ii) increasing innovation and skills of young people and adults to enhance employment; and (iii) increasing coverage and adequacy of social protection and health insurance to reduce the share of population at risk of poverty. The informal economy continues to have negative impact on the business environment and undermines public revenue collection, which is particularly relevant for the post-pandemic recovery. Increased funding for research and innovation, and nurturing innovative businesses could further strengthen competitiveness. Despite increasing educational attainment, young people face difficult labour market transition pointing to issues with relevance and quality of the education system. 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 started developing a Youth Guarantee implementation plan to address the situation. The allowances paid under the Economic Aid scheme are too low to combat poverty, but the government took temporary measures to increase them and started a process to review their adequacy. Social services are scarce to enable active inclusion of vulnerable people. The state budget resources for the development of new social services increase very slowly and the mode of their disbursement shows challenges as regards the sustainability of the new services. The healthcare system is underfinanced with a significant share of uninsured people. The government took steps to increase healthcare coverage, 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.

Participants welcome that Albania made progress concerning annual national accounts, excessive deficit procedure notifications, quarterly government finance statistics (by providing pilot data), harmonised indices of consumer prices and research and development statistics. However, significant progress is still needed in the domains of the excessive deficit procedure and national accounts, including quarterly national accounts. Labour market statistics and short-term business statistics also need attention.

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

1. If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; provided the economic recovery is well entrenched, plan in the medium-term budgetary framework a gradual reduction of the public debt ratio and a return to a positive primary balance by 2024, while lowering the general government arrears below 2.5% of total expenditures in 2022. Restrict budget revisions to the regular revision process set out in the Budget Law and use the regular legislative process should an amendment of the Budget Law become necessary. Assess the fiscal risks from state-owned enterprises and develop proposals for their mitigation.
2. Implement the activities outlined in reform measure 10 of the ERP on Public Strategic Investments and in the PFM strategy to improve the management of public investments including PPPs. Adopt the medium-term revenue strategy following an intensive public consultation, and complement it with a budgeted, operational implementation plan to guide tax policies in the coming years. Continue to increase the shares of spending on education, health, social protection, and R&D in total public expenditure.
3. Carefully assess and analyse price developments and stand ready to tighten monetary policy, if needed, to preserve price stability in the medium term. Ensure a transparent and accurate reporting of asset quality and adequate provisioning, further reduce remaining obstacles to NPL resolution, particularly by resolving the bailiff deadlock, and reduce data gaps in particular as regards the real estate sector. Foster the implementation of measures aimed at promoting saving and borrowing in national currency and at limiting the use of foreign currency in the real economy, including through measures in the remit of the government in line with the Memorandum of Cooperation.
4. Provide enhanced business support services to improve access to finance and entrepreneurial know-how. Assess the effectiveness of the consultation mechanism and then revise it with input from businesses and social partners in order to make the process more comprehensive, practical and transparent. Design a strategic and coordinated action plan for implementing anti-informality policies, based on, but not limited to, the medium-term revenue strategy.
5. Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation. Conduct the regional labour market analysis in all regions, institutionalise the national skills needs analysis and utilise these tools together with the Labour Market Observatory to improve the labour market relevance of initial and continuous vocational education and training for young people and adults and to target the use of active labour market measures. Encourage cooperation between innovative businesses 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.
6. Finalise the assessment of adequacy of 'Economic Aid' benefits, increase their adequacy as of 2023, and establish a mechanism for their annual indexation. Increase allocation to the National Social Fund to ensure coverage, provide additional support to municipalities with limited resources, and improve the sustainability of newly established social services through continued contribution beyond the third year under a condition that municipalities establish a Local Social Fund with sufficient budget. Redesign reimbursement policy for outpatient medicine to reduce financial hardship, particularly among persons with disabilities and chronic disease, poor households, people aged 65 and over, and minorities.

Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2022-2024 with a very significant delay on 24 March 2022, which creates an impediment to perform a substantial dialogue and to properly assess policy plans to address the significant economic challenges the country is facing. The country's repeated non-compliance with agreed procedures also raises doubts about the commitment of stakeholders responsible for delays in the adoption and submission of the ERP. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been implemented to a limited extent.

The economy experienced a strong recovery from the COVID-19 crisis, with year-on-year output growth of 7.1% in 2021. Exports and private consumption were the main growth drivers, while investment growth remained muted. The current account deficit narrowed to 2.1% of GDP in 2021, largely thanks to an improvement in the trade balance of goods and services, while net FDI inflows increased and almost covered the current account deficit. Backed by strengthening growth and governmental support measures, employment recovered from losses during the COVID-19 crisis, while the unemployment rate dropped to 16.1% in the fourth quarter of 2021. However, the overall labour force continued to decline, partly as a result of a persistent brain drain. International institutions expect moderate GDP growth in the post-crisis years, of slightly above 3%, partly due to the lack of structural reforms negatively impacting foreign and domestic investment. The Economic Reform Programme (ERP) expects economic growth to accelerate to about 3½% a year on average, supported by an acceleration of structural reforms. Key domestic downside risks are a continuation of the reform stalemate, which would impede investments, while on the external side the COVID-19 pandemic and the fallout from Russia's invasion of Ukraine could seriously undermine growth prospects, including through accelerating food and energy price pressures and potentially tightening financial conditions.

Concerning public finances, general government data for 2021 has not yet been published. However, entity-level public accounts indicate a marked recovery in revenues and a reduction in social transfers and subsidies compared to the high base in 2020. The public debt ratio rose only moderately, from 32% of GDP at the beginning of the COVID-19 crisis to some 35% in the second half of 2020, and has largely remained at this level since then. However, public finances are weakened by contingent liabilities, in particular in the area of public enterprises. There is a significant degree of non-alignment with EU public sector accounting standards, which strongly impedes the assessment of the country's actual fiscal position. As a result, both the deficit and debt ratio could be significantly higher than reported. In view of high uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide targeted and temporary support to vulnerable households and firms if needed would be appropriate.

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. Headline inflation has been accelerating in line with global trends, reaching 8.1% y-o-y in February, while there are no published data on core inflation, a key measure for analysing price pressures. The domestic political tensions led to a delay in appointing a new board of the central bank. The financial system appears solid and is closely monitored by the two banking supervision agencies and the central bank. Overall, the banking sector features robust capital buffers and liquidity remains high. Bank profitability started to improve after the fall during the pandemic. The quality of loan portfolios remained solid, despite expiring policy support. While a few support measures are still in place, NPLs are not expected to rise significantly, given the modest take-up of government moratoria and the low share of portfolio still affected by debt relief measures. A comprehensive assessment of risks is hampered by data availability, in particular as regards real estate statistics. There was limited progress on removing remaining obstacles to an effective and

swift NPL resolution, such as further enhancing the possibility to negotiate out-of-court restructurings or securitise and sell NPLs. The Deposit Insurance Agency should further increase the coverage of insured deposits and increase its funding.

The country's determination and ability to tackle the identified structural challenges in a forthright manner, supported by the effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine the potential for fostering post-pandemic recovery and economic resilience as well as boosting inclusive growth, competitiveness and accelerating the transition to a greener and more digital economy. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, including by a swift introduction of a system of verification of asset declarations of judges and prosecutors and members of the High Judicial and Prosecutorial Council in line with European standards, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth remain (i) improving the business environment through closer cooperation and coordination at all levels of government, (ii) making the public sector more efficient, in particular improving the performance, transparency and accountability of state-owned enterprises (SOE), and (iii) increasing employment, particularly of young people, women and people in vulnerable situations. Efforts towards coherent countrywide solutions to support the business environment and to strengthen the common internal market within the country have stagnated due to the ongoing political crisis. Policy coordination at all levels is required to implement much needed structural reforms to enhance economic performance. The COVID-19 pandemic and the economic impact of Russia's war against Ukraine has further increased the importance and urgency of overcoming the political crisis and of addressing structural weaknesses. Some progress was made towards online business registration in both entities, also in view of reducing the significant informal economy. However, further progress is needed, and obtaining licences and permits remains a complex and fragmented process with insufficient countrywide harmonisation. Bosnia and Herzegovina has unfortunately made little progress towards a harmonised, countrywide electronic identity and signature system. More needs to be done to foster digital solutions contributing to a sustainable economy, better public services to businesses and citizens and implementation of customs legislation providing for simplified customs procedures in line with the Digital Agenda for the Western Balkans and the Economic and Investment Plan. Further efforts are also required for enhancing public finance management, as well as significantly stepping up SOE sector reform, starting with enhancing oversight and transparency. A large share of the population is inactive and access to the labour market is 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 important progress by the submission of an excessive deficit procedure notification and progress on national accounts by improving the length of time series. Progress in other statistical areas such as labour market statistics and harmonised indices of consumer prices was, however, limited. While efforts should be pursued to improve the coverage and timeliness of all statistics, priority should be given to national accounts, excessive deficit procedure and government finance statistics. Bosnia and Herzegovina has yet to provide monthly data on balance of payments, and needs to align 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. If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; provided the economic recovery is well entrenched, return to a debt-stabilising fiscal policy as of 2023 and foresee a gradually improving primary balance in the medium-term fiscal plans. Increase the share of government capital spending in GDP, by measures to improve public investment management and through an accelerated implementation of those investment projects that have been subject to a clear positive cost-benefit assessment. In order to improve the efficiency of tax collection, ensure an effective exchange of taxpayer information 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, with a particular emphasis on those related to the COVID crisis response, and prepare a strategy on how to contain the emergence of new contingent liabilities and manage risks related to existing ones. Strengthen the analytical capacities of governmental institutions at all levels of government, in particular the BiH Ministry of Finance and Treasury with a view to improving the preparation and quality of the ERP in line with EU requirements. Invest more significantly in building up the country's statistical capacity for macroeconomic statistics, regional accounts, labour force survey and government finance statistics, and pursue efforts to improve the coverage and timeliness of all statistics.
3. Carefully assess and analyse price developments, supported by the statistical offices through improving price statistics, including a timely update of CPI weights and publishing core inflation series. Ensure a transparent and accurate reporting of asset quality and adequate provisioning, improve the NPL resolution framework for instance by further reducing institutional and legal obstacles, and reduce data gaps in particular as regards the real estate sector. Safeguard the integrity of the currency board arrangement and the independence of the central bank, and appoint the Governing Board members without further delay.
4. With a view to improving the business environment and strengthen the single economic space, simplify business registration as well as licensing and permitting procedures and harmonize them across the country. To foster digitalisation of public services and to complement the development of e-Government infrastructure, adopt the law on electronic identity and trust services for electronic transactions with a single supervisory body in line with the EU acquis and ensure that Indirect Tax Authority, whose ability to fulfil its vital country-wide role must be maintained, begins issuing of electronic signatures. Once the 2015 Customs Policy Law will have entered into force, implement the new computerised transit system (NCTS) at national level, as well as the authorised economic operator (AEO) concept.

5. Adopt a comprehensive, country-wide Public Finance Management Strategy in BiH with performance-based monitoring and reporting. Create/update in both entities publicly available registers of public enterprises with complete, searchable list of all public enterprises including comprehensive financial statements, audits and organizational information. Establish public enterprises central oversight units in both entities and allocate adequate human resources.
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 submitted its Economic Reform Programme 2022-2024 on 31 January 2021. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been partially implemented.

The stronger than expected economic rebound in 2021 was driven by the quick revival of diaspora tourism and sizeable government support. After increasing by 10.5% in 2021, the ERP expects real GDP to expand by 7.8% in 2022 and continue growing by some 7% in 2023-2024, well above historical trend rates. An expected large surge in private and public investment is seen as a key growth driver. There are downside risks to this outlook stemming from remaining pandemic-related uncertainty and persistent under-execution of public capital spending. Further downside risks to the outlook, in particular via higher energy and food prices, have emerged in the context of Russia's invasion of Ukraine, and which could also lead to less dynamic trade developments with the main EU and non-EU trading partners and potentially tightening financial conditions.

The programme projects the headline budget deficit to widen to 4.6% of GDP in 2022 in light of the planned fiscal stimulus. According to the fiscal rule definition, which excludes some capital spending, the deficit is set at 2.9% of GDP. A gradual return below the deficit ceiling of 2% of GDP, prescribed by fiscal rule, is envisaged, but its timing may be impacted by the economic outlook. Due to the lack of sovereign rating, Kosovo has only very limited access to international credit markets, and finances its deficit via domestic financing and International Financial Institutions. Near term fiscal risks, some of them included in the programme, stem from pressure for new social benefits and an under-execution of capital spending. Moreover, in view of high uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide targeted and temporary support to vulnerable households and firms if needed is appropriate.

Structural reforms on the budget revenue and expenditure sides should continue to improve the quality of public finance. Budget revenue relies on a narrow tax base, which is weakened by exemptions and preferential tax rates. Public spending suffers from inadequate targeting and transparency of social transfers and weaknesses in investment management. There is a need to reform the social security system, including the revision of the war veteran pension scheme, and to ensure a coherent, fair and fiscally affordable compensation system for public employees. Public investment would benefit from more realistic planning and reforms to address implementation gaps. Fiscal risks related to publicly owned enterprises should be better monitored and included in the budgetary planning. Building on recent progress, the proper fiscal evaluation and costing of initiatives before adoption is crucial to maintain sound public finances.

Headline inflation has been accelerating in line with global trends, while there is no time series published on core inflation, a key measure for analysing price pressures. The banking sector remained sound according to headline figures. Banking sector profitability has increased considerably and both liquidity as well as capitalisation buffers remain far above their regulatory minima. Lending to the private sector accelerated throughout 2021, with both lending to non-financial corporations as well as household lending picking up. Deposit growth of the private sector accelerated as well, supported by the inflow of remittances, as well as the one-off withdrawals from the Kosovo Pension Saving Trust. Despite the phasing out of the COVID-19-related measures, the NPL ratio remained remarkably stable, supported also by the denominator effect of high credit growth. While the current system of private bailiffs appears to work well, structural problems to

* 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.

NPL resolution related to the rule of law and the efficiency of the court system persist. A 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 and the Economic and Investment Plan for the Western Balkans, will determine the potential for fostering post-pandemic recovery and 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 are: (i) tapping into the potential of renewable energy and energy savings and fully opening the retail energy market while providing support to vulnerable groups to address energy poverty and the turbulence in the energy market; (ii) continuing to formalise the economy and address the low competitiveness of the private sector; and (iii) improving the quality and relevance of the education system to increase employment and mitigate skills mismatches. Persistent widespread informality limits the fiscal space for public spending in priority areas, the development of the private sector including foreign direct investment flows and access for the workforce to adequate levels of social protection and training. Kosovo has a strategy designed to address the key underlying causes of informality, including credible and significant targets for the reduction of the size of the informal economy. While progress was made despite obstacles related to the COVID-19 pandemic, implementation must be improved and the corresponding action plan is outdated and must now be extended beyond 2022. Strong political support, effective implementation and close monitoring are required to achieve the desired outcomes, while measures to address the underlying causes of informality related to the business environment should complement the strategy. The inadequate and unreliable supply of energy is a serious constraint on business and competitiveness and has exacerbated the recent energy crisis. Kosovo is investing in renewables, but a new, competitive auction-based system is required to unlock further needed investment. Despite positive developments, the main generation activities will continue in the short- to medium-term to rely on coal. However, the upcoming energy strategy should plan to diversify the power generation and increase capacities in renewables and in storage. To achieve these plans, further effort is required to develop alternatives to polluting sources of energy. Kosovo suffers from high levels of electrical grid losses and investment and maintenance in this area remain low. The potential for savings through energy efficiency measures remains significant.

Young people in Kosovo face a very difficult transition from school to employment, with a very high share of them being not in employment, education or training. Kosovo has started developing a Youth Guarantee implementation plan to address the situation. In view of helping jobseekers, including young people, a series of reforms were started to modernise the public employment service (PES) to provide tailored services, but they hinder on insufficient human and financial resources of PES. The quality and results of the education system rank very low in international comparisons. Effective quality assurance is one of the weakest points across all levels of education. Aligning policies, training programmes and curricula to the current and future needs of the labour market is challenging although relevant tools and sector studies exist that identify current and future skills needs. Social dialogue needs to be further developed, in particular in the private sector.

Participants take note of Kosovo's achievements concerning the transmission of national accounts, excessive deficit procedure, government finance, harmonised index of consumer prices, balance of payment and international investment position data. However, data for several statistical domains such as short-term business statistics and research and development are missing. Although

important progress was made in 2021, 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 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; provided the economic recovery is well entrenched, and as envisaged by the ERP, target in the 2023 budget and medium-term expenditure framework a return to the 2% deficit ceiling of the fiscal rule. Ensure proper costing of new pension and social policy initiatives and compliance with the legal ceiling applicable to the public wage bill and spending on war veteran pensions. Undertake and publish a review of tax expenditure quantifying the size of the revenue forgone from all exemptions and reduced rates.
2. Improve the execution of capital spending by implementing the recommendations made under the IMF's Public Investment Management Assessment. Improve the financial oversight and accountability of publicly owned enterprises (POEs) and continue regular quarterly reporting on all POEs. Review the options paper on the establishment of an independent body for fiscal oversight, so that the suggested options ensure operational independence and adequate budgetary safeguards.
3. Carefully assess and analyse price developments, publish time series for core inflation and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Ensure that core areas of the central bank, including financial stability and banking supervision, are adequately staffed. Continue to ensure a transparent and accurate reporting of asset quality and adequate provisioning, further reduce remaining obstacles to NPL resolution and continue to reduce data gaps in particular as regards the real estate sector.
4. Adopt a coherent long-term energy and climate strategy for lowering carbon emissions, including plans for a phase-out of coal and fossil fuels subsidies as committed under the Sofia Declaration. In line with the commitments of the Green Agenda for the Western Balkans: increase energy efficiency incentives for the private sector and households and improve the support schemes for renewable energy projects with the introduction of competitive bidding/auctions; adopt an action plan for the gradual adjustment of energy tariffs reflecting actual costs and providing mitigation measures for vulnerable consumers, and implement the plan to liberalise the retail energy market.
5. Update the action plan of the 2019–2023 National Strategy for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes, and ensure its implementation. Improve the business environment through measures to simplify, merge, abolish and digitise licenses and permits with an aim to reduce the barriers to formalisation of employment and businesses and continue to address tax evasion in identified high-risk sectors in line with the strategy and the action plan, which should be updated based on sector risk assessments and tax gap analysis. With an aim to prevent evasion of property income tax, improve transparency by publishing all sales prices of real estate property.

6. Thoroughly apply existing quality assurance mechanisms at all levels of education through increased school inspections, including training of inspectors, and effectiveness of quality coordinators, as well as monitoring and follow up procedures of higher education institutions and their study programmes by the Accreditation Agency. Narrow the skills mismatch gap by upgrading and using existing skills needs monitoring and forecast mechanisms as well as by increased cooperation with social partners and businesses for an informed planning of initial and continuous vocational education and training, curriculum development and adequate active labour market measures. Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation.

Montenegro

Montenegro submitted its Economic Reform Programme (ERP) 2022-2024 on 31 January 2022. However, on 4 February, the Montenegrin Parliament passed a no-confidence motion in Prime Minister Zdravko Krivokapic's coalition government. This results in a substantial degree of uncertainty about the validity of the programme's macroeconomic and fiscal projections and the underlying policy measures. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been partially implemented.

The reopening of borders contributed to a strong rebound of the economy in 2021, driven by a quick revival of tourism and related services. Following one of the deepest recessions in Europe in 2020, real GDP grew at a double-digit rate of 12.4%. Over the programme period, the economy is expected to benefit from a strong fiscal stimulus in 2022, supporting households' income and lowering the tax wedge, as well as from an ambitious multi-annual investment programme. However, risks are to the downside. A new wave of the pandemic and the fallout of Russia's war of aggression against Ukraine could hold back tourism activity, further accelerate food and energy price pressures and lead to tighter financial conditions. Increasing political uncertainty could negatively affect investments, slowing down Montenegro's economic recovery. Moreover, substantial increases in wages and commodity prices may further exacerbate inflationary pressures, while import growth may turn out higher than expected if investment plans are fully implemented.

The economic rebound boosted budget revenues in 2021, enabling a very sizeable decline of the deficit, which came in lower than planned at an estimated 2% of GDP, compared to 10.2% GDP in 2020. Thanks to the economic rebound and the use of accumulated deposits to repay maturing debt, the public debt ratio declined significantly, by some 20 pps, but remained high at 85% of GDP in 2021. Debt composition improved thanks to a hedging arrangement that shelters public finances from currency risk. The 2022 budget targets a sharp increase in the deficit, which limits the fiscal space available for additional discretionary measures should they become necessary. The deficit increase is driven by the elimination of health contributions in an effort to lower the tax wedge, and new social spending initiatives. Over the medium term, the ERP projects public debt to decline further and fall below 70% of GDP in 2024, driven by expenditure-based consolidation which is, however not further specified in the programme.

In view of high uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide targeted and temporary support to vulnerable households and companies if needed would be appropriate. With the economic recovery progressing, fiscal sustainability needs to be enhanced by a medium-term plan for debt reduction based on specific 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 also requires improvements in fiscal governance and in public investment management. Often, Parliament adopts new expenditure initiatives without properly taking into account their fiscal implications. Large infrastructure projects should be better managed and prioritised in light of the available fiscal space. Following up on plans to set up an independent fiscal institution would contribute to better fiscal policymaking.

Inflation has accelerated in line with global trends, and upside risks remain elevated. The banking system has remained sound. On the back of the strong economic recovery, key financial stability indicators of the banking system improved despite the gradual unwinding of crisis support measures. In particular, the banking system enjoys adequate capital and liquidity buffers. The completion of the Asset Quality Review is welcome, provides a strong basis for updating supervisory data and requires a timely follow up on the findings. As delayed effects of the pandemic crisis on asset quality can materialise in the coming months as support measures are

being phased out, it remains important to strengthen the forward-looking monitoring of bank's asset quality and ensure sufficient provisioning. Private sector credit growth remained moderate in 2021, turning negative in real terms by the end of the year. In order to support the private sector's access to finance, the Government has established a Credit-Guarantee Fund. The authorities have also made progress in financial sector reforms, including in advancing key legislations that align Montenegro's regulation and supervision with the current EU framework. A 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 NPL resolution. The central bank has identified slow NPL resolution as a major challenge in a recent survey and set up inter-ministry working groups to discuss solutions.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by the effective use and implementation of IPA support and the Economic and Investment Plan for the Western Balkans, will determine the potential for fostering post-pandemic recovery and economic resilience as well as boosting inclusive growth, competitiveness and accelerating the transition to a greener and more digital economy. While the Government has made efforts to improve project preparation within the Single Project Pipeline, there remains a wider need to have in place a strong market-analysis on the potential for attracting investments that can bring sustainable growth and development in Montenegro and to identify areas best suited for state support.

In order to address the identified structural challenges and effectively implement the Economic and Investment Plan for the Western Balkans, the government needs to make further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue. The main challenges for the Montenegrin economy in terms of boosting competitiveness and ensuring long-term, inclusive growth 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 continue to focus on making the regulatory environment business-friendly. The digitalisation of public administration, together with full implementation of e-procurement, have the potential to enhance the efficiency and transparency of the regulatory environment, reduce costs and limit possibilities for corruption. Continuous dialogue and cooperation, involving state, local administration, businesses and civil society partners is instrumental. A further priority is to reduce the size and scope of the informal economy. The "Europe Now" reforms of 2021 decreased the tax wedge on labour and, together with reforms in the regulatory environment, could have a significant impact on informality. Monitoring the impact of these reforms and designing follow-up actions, including a comprehensive plan to reduce informality, is necessary to achieve lasting results. The persistently low activity and high unemployment rates, especially among women, young people and the low-skilled and high long-term unemployment have been further exacerbated by the COVID-19 crisis, from which the labour market has not yet recovered. The rate of young people not in employment, education or training remains high. Montenegro has started developing a Youth Guarantee implementation plan to address the situation. Skills mismatches remain an obstacle to transitioning into employment. The improvement of the effectiveness of active labour market measures and coordination between employment and social services recorded limited progress and therefore disincentives to work persist. In parallel, some progress in strengthening social dialogue has been seen in 2021. Efforts of the government to improve the broader innovation ecosystem have taken a step forward with the establishment of the Innovation Fund.

Participants take note that Montenegro made progress in several statistical areas, namely in national accounts (by providing all output components and almost all expenditure and income annual data) and foreign direct investment. Montenegro is encouraged to close remaining gaps in national

accounts and balance of payments. The harmonised indices of consumer prices and the alignment with new requirements in short-term business statistics, as well as monetary and financial statistics need further attention. Montenegro should also give priority to the transmission of excessive deficit procedure notifications and government finance statistics as Eurostat is, at this stage, unable to assess their compliance.

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

1. Strengthen fiscal sustainability by reintroducing the initially planned revenue measures of the 2022 budget while providing additional targeted support to vulnerable households and firms if needed to cushion the impact of adverse shocks. Use any excess revenues to contain the 2022 deficit. Adopt a new medium-term fiscal strategy with the 2023 budget, including concrete consolidation measures and targeting a primary surplus as of 2024 and continued public debt reduction over the medium-term, should the recovery be firmly entrenched.
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 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, prepare concrete budgetary recommendations to reduce tax expenditure (like exemptions, deductions, credits, deferrals, etc.) and share this analysis with the Commission.
3. Carefully assess and analyse price developments, and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Ensure a transparent and accurate reporting of asset quality and adequate provisioning as well as a timely follow up on findings from the Asset Quality Review, 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. Finalise an analysis of barriers to businesses at the local administration, propose improvements to the institutional and regulatory environment on this basis and start to implement them. Continue implementing digital services for micro, small and medium enterprises and prioritise the development and implementation of interactive e-government platform for transactional electronic services. Adopt a strategic plan for “Montenegro works” and perform an analysis of Montenegrin state-owned enterprises to prepare a proposal for the optimal portfolio of state ownership.
5. Complete the survey on informality and assess the short-term effects of the “Europe Now” programme. Analyse the results and feed them into a comprehensive action plan to tackle informality and start its implementation. Ensure structural cooperation between central and local authorities in the development and implementation of the plan, including on preventing measures and incentives to legalise informal businesses and employees.
6. Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation. 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 its implementation and continue implementing the reforms. 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.

The Republic of North Macedonia

North Macedonia submitted its Economic Reform Programme 2022-2024 on 31 January 2022. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been partially implemented.

Following a solid recovery from the COVID-19-induced recession with real GDP growth estimated at 4% in 2021, the programme's baseline projects economic growth to accelerate over 2022-24 to an average annual rate of 5.2%, which considerably exceeds the pre-COVID-19 historical average. A large rise in public investment, increasing disposable incomes stemming from solid employment growth and strengthening transfer inflows from abroad, flanked by continued government support measures are projected to be the key determinants for investment and household consumption. While a gradual stabilisation of global supply chains would have a positive effect on exports, strong domestic demand and a high import content of exports is set to boost imports, leading to a projected small negative contribution of net exports to growth in the coming years. In a context of high uncertainty, the growth outlook is subject to a series of downside risks stemming from the impact of Russia's war against Ukraine and the future course of the COVID-19 pandemic, in particular global and domestic inflationary pressures and potentially tightening financial conditions. Large implementation risks with regard to private and public investment, such as weakening business confidence and shortcomings in public investment management, could also weigh on the growth outlook. War-related risks could in particular translate into further rises of energy and food prices and less favourable external trade developments due to a deteriorated growth outlook in the main trading partners in the EU.

Public finances improved in 2021. Thanks to a recovery in tax revenue, the fiscal deficit narrowed significantly, to 5.4% of GDP. This came in spite of further crisis-related spending on transfers and subsidies to households and companies, and on government consumption. General government debt amounted to 51.8% of GDP in 2021, which was marginally below its level of one year earlier. The programme projects fiscal consolidation to progress between 2022 and 2024, with the general government deficit to drop to 2.9% of GDP by 2024, based mainly on savings in current expenditure, as COVID-19-related support measures are phased out.

In light of high uncertainty about the pandemic and the impact of Russia's war against Ukraine, standing ready to provide well-targeted and temporary support to vulnerable households and companies if needed would be appropriate. Provided the economic recovery remains on track, fiscal policy should increasingly focus on deficit and debt reduction and the re-building of fiscal buffers. This should be bolstered by the implementation of the Tax System Reform Strategy with revenue-enhancing measures, such as a broadening of the tax base through reducing tax expenditure. In order to realise the ambitious plan to raise public capital spending, the management of public investment needs to be improved, including a wider use of well-managed public-private partnerships. The consolidation of public finances needs to be supported by improved fiscal governance through the swift introduction of fiscal rules and the establishment of a fiscal council, building on progress achieved in the preparation of a new organic budget law.

Monetary policy has been appropriately accommodative. The rise in inflation mainly reflects global factors, but there are increasing signs of second-round effects, including from wage increases. Going ahead, vigilance is needed in view of a widening inflation differential with the euro area, and inflation expectations should be closely monitored. The banking sector remained sound, and financial stability was maintained amid strengthening credit growth. The overall indicators on capital adequacy, liquidity and profitability remained sound thanks to the strong economic recovery and the gradual approach in phasing out support measures. Regulatory and supervisory support measures have already expired. As economic support is gradually withdrawn, non-performing loans (NPLs) could still increase, but are expected to remain at manageable levels. A comprehensive

assessment of risks is hampered by data availability, in particular as regards real estate statistics. Continued improvement in real estate related data would support monitoring and assessment of the related risks. Building on the success in improving financial sector legislations and enabling the sale of NPLs, the authorities could further strengthen the broad legal, judicial and regulatory framework to expedite NPL resolution. The recent increase in reserve requirements for foreign currency liabilities could help address the recently observed reversal in the denarisation trend amid still significant currency substitution, which requires continued attention. Central bank independence should be preserved, including by excluding the central bank from the law on administrative servants and the law on public sector employees.

The government's determination and ability to tackle the identified structural challenges in a forthright manner, supported by the effective use and implementation of IPA and the Economic and Investment Plan for the Western Balkans, will determine the potential for fostering post-pandemic recovery and economic resilience as well as boosting inclusive growth, competitiveness and accelerating the transition to a greener and more digital economy. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) improving the competitiveness of domestic companies, including integration into global value chains (GVCs) and reducing the informal economy; (ii) energy sector modernisation and transition to clean energy; and (iii) improving the quality and relevance of the education system to increase employment and mitigate skills mismatches. Important factors that undermine the competitiveness of domestic companies, investment and GVC integration include a challenging business environment, a lack of skills, innovation and technology adoption, low productivity and the need to modernise and digitalise public administration. The regulatory framework's lack of transparency and predictability continues to negatively affect the business environment and the competitiveness of domestic companies, in particular SMEs. The rebound from the COVID-19 pandemic continuously highlights the need to address challenges posed by the large informal economy in a decisive manner. Rising geopolitical tensions, increased commodity price volatility combined with supply-chain disruptions negatively affect sustainable growth and competitiveness. The country's high dependence on energy imports, high energy intensity, persistent high dependency on highly polluting lignite coal, as well as inefficient energy consumption highlight the importance of a green transition as also identified in the recently adopted Government program.

In addition to short-term measures aimed at mitigating the economic impact of the war in Ukraine, efforts are required to diversify energy supply, increase the share of renewable energy resources and to swiftly proceed with measures to improve energy efficiency. Implementation of the Economic and Investment Plan for the Western Balkans, strengthening connectivity and going towards greener and more digital economies, will assist in diversifying energy supply and in reducing dependencies from Russian oil and gas imports. Insufficient quality of education contributes to persistent unemployment and a high share of young people not in employment, education or training. Youth Guarantee has been implemented countrywide to partly address the situation, yet the reform of education is a primary concern to improve employability. North Macedonia plans to start an annual reporting procedure in order to develop recommendations for improving higher education. These recommendations should lead to the development of a new formula for financing higher education. 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 welcome that North Macedonia made progress concerning foreign direct investment, quarterly government finance statistics (by providing experimental data for quarterly non-financial general government accounts), excessive deficit procedure notifications and monetary interest rate statistics. Further progress is expected regarding adherence to excessive deficit procedure methodology. North Macedonia needs to improve its compliance level on quarterly national accounts. 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. If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; foresee in the medium-term fiscal plan accompanying the 2023 budget a gradual reduction of the primary deficit-to-GDP ratio to its pre-crisis (2019) level. Set up a central public investment management unit in the Ministry of Finance and ensure its proper functioning. In line with the Tax System Reform Strategy, design comprehensive tax reforms and draft legislative changes that contribute to enhancing revenue by broadening the tax base, and accelerate the digital transformation of the Public Revenue Office.
2. Submit the new public-private partnership (PPP) law to the Parliament for adoption and ensure its implementation, including by setting up a fully functioning PPP registry. Ensure central monitoring of all fiscal risks related to state-owned enterprises, PPPs, and Local Government Units by the Ministry of Finance. Implement the new organic Budget law as soon as it is passed by the Parliament and take the necessary legislative and organisational steps to enable the new Fiscal Council to take up operations.
3. Carefully assess and analyse price developments and stand ready to tighten monetary policy, if needed, to preserve price stability in the medium term. Maintain a transparent and accurate reporting of asset quality and adequate provisioning, further reduce institutional and legal obstacles to swift and effective NPL resolution, all relevant institutions to continue to reduce data gaps in particular as regards the real estate sector and further implement measures to promote the role of the local currency. Safeguard the national bank's independence in its key statutory tasks, including in staffing issues, in line with the law on the national bank, and to this end exclude the national bank from the scope of the new law on administrative servants and the law on public sector employees.
4. Use the list of mapped para-fiscal charges to evaluate, optimise and rationalise para-fiscal charges at central and local levels. Continue the digitalisation of public services for businesses and citizens by upgrading and enhancing the use of e-portals for services. Adopt a comprehensive new strategy and Action Plan for formalisation of the informal economy 2023-2025 and ensure high level political commitment by all institutions relevant for the coordination and implementation.
5. Increase the number of staff and the technical/engineering capacity of the Energy Department in the Ministry of Economy and the Energy Agency. In line with the commitments of the Green Agenda for the Western Balkans: Adopt and implement energy efficiency legislation, including bylaws to the energy efficiency law. Following development and adoption of the legal and regulatory framework, establish the envisaged Energy Efficiency Fund.

6. Develop new vocational education and training (VET) legislation with a focus on inclusion, labour market needs and a new methodology of financing VET as well as provide a yearly report for improving higher education, including recommendations for a new formula for the financing of higher education. Continue efforts to strengthen access to active labour market policies, particularly for low-skilled unemployed and people in vulnerable situations. Further 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.

The Republic of Serbia

Serbia submitted its Economic Reform Programme 2022-2024 on 31 January 2022. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been partially implemented.

After a relatively mild contraction in 2020 and a strong economic rebound in 2021, the ERP's baseline scenario projects continued robust GDP growth of close to 5% on average in 2022-24, i.e. around one percentage point above the pre-COVID-19 growth rates, driven by buoyant private consumption, investment and exports. The current account deficit broadly stabilised in 2021 and is expected to only slightly widen in the period 2022-2024. In a context of high uncertainty, the growth outlook for 2022 is, as elsewhere, subject to a series of downside risks stemming from the economic impact of Russia's war against Ukraine and the future course of the COVID-19 pandemic, in particular global inflationary pressures and potentially tightening global financial conditions. War-related risks could in particular translate into further rises of energy and food prices and less favourable external trade developments due to a deteriorated growth outlook in the main EU and non-EU trading partners.

The strong economic recovery and lower fiscal support led to a marked decrease in the general government deficit to 4.1% of GDP in 2021, notwithstanding a sizeable increase in capital expenditure. The 2022 budget aims to further lower the deficit, to 3% of GDP, mostly through the non-renewal of COVID-19 crisis support. The ERP's fiscal scenario projects further gradual consolidation in the period 2023-2024 towards the pre-crisis fiscal position, i.e. a budget close to balance, mainly driven by expenditure growing more slowly than nominal GDP. The debt-to-GDP ratio has declined in 2021 to 57.1% and is projected on a declining path in 2022-2024. In view of high uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide temporary and well-targeted crisis mitigation if needed would be appropriate. A gradual return to the pre-crisis budget balance, contingent on the economic outlook, is key to rebuilding fiscal space in the medium term. To reinforce the medium-term sustainability of public finances, remaining gaps in fiscal governance need to be addressed, in particular as regards fiscal rules and the containment of the public sector wage bill. Increased transparency on fiscal risks, in particular related to state-owned enterprises (SOEs), improvements in SOE governance and further reforms of revenue administration would also contribute to further enhancing medium-term policy credibility and reducing the informal economy.

The central bank has taken various measures to both support the economy, especially during the pandemic waves, and to maintain price stability, in light of the global cost-push pressures contributing to increasing inflation since autumn 2021. It has taken steps to reduce monetary accommodation by increasing sequentially its average reverse repo rate since October 2021 and by raising the key policy rate by 50 basis points to 1.5% in April 2022. While inflationary pressures are deemed to be temporary, risks to inflation are tilted to the upside, also in light of Russia's war against Ukraine, and should be closely monitored. The central bank intervened in the foreign exchange market mainly by purchasing foreign currency (NBS net purchased EUR 645 million) to maintain a stable exchange rate through 2021. The banking system remained stable with sound indicators on solvency, liquidity and profitability. Crisis measures, which supported businesses and banks, are being phased out, with no marked impact on asset quality to date. Risks related to the real estate market are carefully monitored, yet there is room for more detailed data on the real estate sector to enable a more comprehensive assessment. The NPL resolution framework still has margins for improvement and additional progress on removing structural obstacles would be beneficial. Dinarisation continued to increase, also thanks to additional measures taken by the central bank,

while the level of currency substitution continues to pose a tail risk to financial stability 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 the potential for fostering post-pandemic recovery and economic resilience as well as boosting inclusive growth, competitiveness and accelerating the transition to a greener digital economy. This should be underpinned by further substantial efforts to tackle 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, and social protection against poverty. Business predictability should be further improved by ensuring full transparency in the adoption of legislation. A certain share of public funds for capital investment continues to be spent without sufficient transparency and proper checks to ensure compliance with public procurement, state aid and technical standards, particularly when it comes to big infrastructure projects financed by third-country loans. There is a need to strengthen the implementation of the legal framework in the fields of competition and state aid. Serbia remains highly dependent on coal and needs to develop and adopt a coherent long-term strategy that combines energy and climate targets. Major investments are needed to modernise energy infrastructure and lower carbon emissions with a view to the green transition. Further efforts are necessary to diversify supply and Serbia's overall energy mix notably to reduce excessive dependence on gas from individual countries. The public expenditure on social protection in Serbia has been gradually decreasing in recent years and the benefits for the part of the population most in need are not commensurate to the cost of living. The tax wedge of low wage earners remains too high to bring people out of in-work-poverty. A reform of vocational education and training (VET) schools has been started. However, VET education is not well oriented to labour market needs with low exposure of students to the workplace. School-to-work transitions remain structurally difficult leading to a high amount of young people not in employment, education or training. Serbia has started developing a Youth Guarantee implementation plan to address the situation. Social dialogue, in particular in the private sector, needs to be developed further.

Participants welcome that Serbia has reached good level of compliance in the area of national accounts, however, some newly introduced datasets are still considered provisional and temporarily flagged as confidential. Further progress is expected regarding adherence to excessive deficit procedure methodology and government finance statistics. Serbia needs to address missing data series in the area of national accounts and to align with the new requirements in short-term business statistics.

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

1. If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; provided the economic recovery is well entrenched, plan a further gradual return to a deficit close to balance in the 2023 budget and medium-term fiscal framework. Contain overall spending on wages as a percentage of GDP by adopting an adequate wage indexation mechanism and taking preparatory steps towards an appropriately designed public sector wage system reform. Adopt a credible and binding system of fiscal rules for entry into force in 2023 as envisaged in the ERP.

2. To reduce the grey economy, strengthen VAT collection and improve the tax control process, finalise the introduction of the new model of electronic fiscalisation and the transition to electronic invoicing and implement the tax administration reform according to the ERP 2022 timeline. Reinforce fiscal risk analysis capacity, in particular on SOEs, and make resulting reporting publicly available in the fiscal strategy updates in spring and autumn. Implement the time-bound action plan for the deployment of the new SOE ownership and management strategy according to the ERP 2022 timeline to improve the governance of SOEs and reduce related fiscal risks.
3. Carefully assess and analyse price developments and stand ready to tighten monetary policy further, if needed, to preserve price stability in the medium term. Maintain a transparent and accurate reporting of asset quality and adequate provisioning, further upgrade NPL resolution, including by facilitating out-of-court settlement, and continue to reduce data gaps in particular as regards the real estate sector. Continue efforts to promote the use of the national currency, including by enhancing long-term financing in national 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. Continue with the process 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 the principles of competition, equal treatment, non-discrimination and transparency in public procurement and state aid procedures in line with the EU *acquis* for all public investment projects regardless of the financing source and ensure a consistent and transparent track record demonstrating the operational independence of the Commission for State Aid Control.
5. Continue to develop and adopt a national long-term energy and climate plan in line with the Green Agenda for the Western Balkans and international commitments, and further increase investments in modernising energy infrastructure and lowering carbon emissions with a view to accelerating the green transition. Implement outstanding financial and institutional measures for higher take-up of renewables and energy efficiency, including launching first auctions for renewable energy sources (RES) and further develop the newly established administrative entity for energy efficiency and further improve the sustainability of the financing mechanism. With a view to further liberalising the energy market, address outstanding reforms, including price and tariff reform, accelerate the unbundling of all energy utilities in line with the EU *acquis*, and as regards the gas sector in line with Serbia's Action Plan; as regards Gastrans, Serbia should ensure that its regulatory regime is in full compliance with EU legislation all in line with the Action plan developed following the recently opened Cluster 4 for Energy, Climate and Transport in the EU accession process.
6. Reduce poverty by increasing the adequacy of benefits of the Financial Social Assistance (FSA) scheme for individuals and families with children and by increasing substantially the untaxable wage base close or equal to the level of the minimum salary for workers. 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.

Turkey

Turkey submitted its Economic Reform Programme 2022-2024 on 31 January 2022. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 12 July 2021 has been partially implemented.

Turkey's economy experienced a strong economic recovery in 2021, expanding by double-digits, supported by external and domestic demand, and good progress in vaccination rollouts. Private consumption, exports, manufacturing and services performed particularly well. However, by the end of the last quarter of the year, the significant depreciation of the lira, increased market volatility and steep rise in inflation took a heavy toll on economic sentiment. Exchange rate volatility declined markedly, in particular due to the implementation of an FX-protected deposit scheme. The economic reform programme's (ERP) baseline scenario, which projects growth at 5-5.5% per year, appears optimistic and does not take into account the effects of recent policy decisions and Russia's war against Ukraine as it was submitted in January 2022. Sustainably reducing external imbalances remains a key policy target, following notable increases in international trade integration. As other European countries, Turkey's economy is similarly highly exposed to the fallout of Russia's war against Ukraine, in particular via its energy and wheat imports and potentially tightening global financial conditions.

The programme targets fiscal consolidation with the budget deficit expected to fall to 2.6% of GDP in 2024. Since the beginning of the pandemic, budget execution has consistently exceeded expectations. Like in previous years, maintaining fiscal prudence is the cornerstone of the authorities' macroeconomic policy. Fiscal consolidation, largely based on an overly strong reduction of current expenditure and transfers, is planned to continue. However, the medium-term budgetary plan is based on optimistic macroeconomic assumptions. It also insufficiently addresses major structural policy issues, like high energy prices, growing poverty and inequality, and does not include the effects of a number of recently adopted measures. Moreover, in view of high uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide targeted and temporary support to vulnerable households and firms if needed, would be appropriate. The ERP projects government debt to remain below 40% of GDP, although there might be upward pressures due to exchange rate depreciation. Despite an overall conservative fiscal policy and debt management efforts, fiscal and financial risks still remain elevated and should be closely monitored. There are also potentially sizable contingent liabilities from the new FX-protected deposit scheme. The programme outlines further efforts to improve the quality of public finance but, in the absence of strong fiscal anchors, the medium-term budgetary framework is subject to frequent changes and is not sufficiently credible and binding.

Inflation increased to very high levels in recent months, on the back of various factors, including also the impact of the COVID-19 pandemic, the high level of global commodity prices further increasing because of war in Ukraine, supply bottlenecks, currency depreciation and the level of interest rates. The change of the central bank governor in March and of three members of the Monetary Policy Committee in October, including two deputy governors, have been unexpected, raising concerns including by many market participants over central bank independence. Monetary policy was loosened (cumulatively by 500 bps) as of autumn, reflecting the CBRT's assessment of the sources of inflation. The authorities subsequently introduced various measures and also intervened in the forex market. Despite improvements in 2021, foreign exchange reserve buffers remain below optimal levels according to some metrics. The banking sector has shown resilience so far. Capital buffers remain above the regulatory minimum, non-performing loan (NPL) ratios have improved and provisions are adequate, while the effects of regulatory flexibilities introduced during the pandemic need to be monitored. Measures taken to better prepare for possible NPL challenges are welcome, while a third-party asset quality review would be beneficial in this context. Banks

remain exposed to indirect credit risks stemming from the elevated share of forex debt of the corporate sector. The recent depreciation of the lira has partially offset nominal deleveraging gains of past years, and further bouts of depreciation amid a slowdown of economic activity remain a risk to financial stability via the impact on corporate balance sheets.

The Turkish economy has shown resilience during the recent years, taking into account that Turkey's total exports remain strong, on the back of the flexibility of exporters to switch between markets and the diversified customer portfolio of tourism industry. Turkey is exposed to the fallout of Russia's invasion of Ukraine, notably because critical agricultural imports from Russia and Ukraine may become unavailable, tourist revenue from these neighbours may shrink and higher global energy prices will dent companies' cost competitiveness and consumers' purchasing power. The long term economic impacts of both the COVID-19 pandemic and 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) improving transparency and predictability in the regulatory and institutional environment affecting businesses; (ii) implementing ambitious climate and environmental policies to ensure the carbon neutrality by 2053 at the latest; and (iii) raising the level of skills in order to increase employment, in particular of women and young people. The timely implementation of the reforms announced by the government against well-defined targets will be a critical factor in the government's policy response for shaping the economy in this new context. These structural challenges will create large investment needs. But given higher risk indicators and a more uncertain geopolitical environment, improving the investment climate will require strengthened efforts to improve the rule of law, enhance transparency, strengthen the independence of regulatory authorities and social dialogue. Designing and implementing structural reforms to improve the investment climate and to reach carbon neutrality will require good governance, coordination and inclusiveness. The labour market has shown a fast recovery from the COVID-19 pandemic, with the employment rate and total employment exceeding pre-pandemic levels. 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. Despite some improvements, the female labour market participation remains structurally low. Lifelong learning measures remain key to ensure the best utilisation of the labour market potential, and increasingly so with a view to the green and digital transitions. Social dialogue remains marginal, considering its potential for employment and social policy.

Participants take note that Turkey has improved compliance with respect to annual national accounts as regards timeliness but data gaps still exist both for annual and quarterly national accounts. Turkey has also made progress regarding adherence to excessive deficit procedure methodology. Turkey should give priority to the timeliness and quality of the transmission of excessive deficit procedure notifications and government finance statistics. Turkey made progress in labour force survey statistics, but it still needs to make some improvements in this area and to align with the new requirements in short-term business statistics.

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

1. Rebalance the policy mix and use the available fiscal space in the 2022 budget to cushion the impact of adverse shocks through targeted support to vulnerable households and firms. Increase the share of local currency in new borrowing and reduce the share of public banks holdings in domestic government debt. Expand the tax base by developing a plan to gradually streamline tax exemptions and reductions.

2. Adopt the new framework legislation on Public Private Partnerships in order to improve their management and monitoring. Simplify public procurement procedures and reduce the number of exemptions. Phase out the FX value guarantees on lira time deposits as envisaged by the end of 2022 or earlier.
3. Use all available monetary policy instruments in line with the central bank's mandate of price stability to ensure a permanent fall in inflation towards the target. Enhance the institutional basis for sustainable price stability in line with operational central bank independence and bolster market confidence. Further strengthen the integrity of financial sector regulatory framework in line with international and EU standards, withdraw the regulatory flexibilities provided to the financial sector during the pandemic, particularly with regard to loan restructuring and NPL recognition practices, encourage high quality credit risk management and enhance confidence by conducting more transparent asset quality reviews and publish its methodology and outcomes.
4. With the aim to improving the business environment, further strengthen the rule of law and the regulatory environment and improve consultation mechanisms with business organisations and social partners on relevant new legislation. Implement legislation and enhance transparency regarding state aid. Finalise the legislation on easing private investments and prepare its implementation. Prepare a new Action Plan for the fight against informal economy and set concrete performance indicators.
5. Take steps to set up a domestic carbon pricing. With a view to meeting the national decarbonisation objective, finalise the long term national energy strategy. In order to adapt to climate change, finalise the update of the national adaptation strategy.
6. Improve the transition of young people into the labour market through active labour market measures, better access to education and improvements in the vocational education and training system. Incentivise female labour market participation through legislative and fiscal measures and provision of appropriate and affordable childcare infrastructure beyond the big urban centres of Turkey. Increase offers and participation in lifelong learning measures and step up re- and upskilling possibilities for the labour force.