

Integration of Structural Reforms and Fiscal Frameworks in Economic Reform Programmes



Funded by the
European Union

Implemented
by the CEF



TABLE OF CONTENTS

| | |
|---|-----------|
| List of abbreviations | 5 |
| EXECUTIVE SUMMARY | 6 |
| I. THEORY BEHIND STRUCTURAL REFORMS AND FISCAL FRAMEWORKS | 8 |
| II. CONSISTENCY OF THE ECONOMIC REFORM PROGRAMME | 10 |
| 1. Overall policy framework and objectives = strategy (including diagnostics) | 11 |
| 2. Macroeconomic and fiscal frameworks | 12 |
| 3. Structural reforms, their costs and financing | 12 |
| III. ASSESSMENT METHODOLOGY | 13 |
| IV. MAIN FINDINGS | 14 |
| 1. Key obstacles to growth | 14 |
| 2. Fiscal frameworks and inclusion of structural reforms | 15 |
| 3. Structural reforms and their integration into the fiscal framework | 16 |
| V. POSSIBLE APPROACHES TO IMPROVEMENT | 19 |
| VI. CASE STUDIES | 21 |
| Case of Albania | 22 |
| Case of Bosnia and Herzegovina | 26 |
| Case of Kosovo* | 31 |
| Case of Montenegro | 35 |
| Case of North Macedonia | 40 |
| Case of Serbia | 46 |
| Case of Turkey | 51 |
| ANNEXES | 56 |
| ANNEX 1: TEMPLATE FOR CASE STUDIES | 56 |
| ANNEX 2: THE STRUCTURAL REFORM INTEGRATION SCOREBOARD | 58 |

PROJECT: Strengthening Line Ministries’ Capacities to Assess Fiscal Implications of Structural Reforms (FISR project)

AUTHORS: Saša Jazbec and Janez Šušteršič in cooperation with Merdža Handalić Plahonjić, Marsed Harizi, Melahat Kutlu, Silvana Mojsovska, Jelena Rančić, Valmira Rexhëbeqaj, Tijana Stanković

Published by: CEF
Editor: Tara Vasiljević
Text editor: Kadri Põdra
Design: Sonja Eržen
Print: Demat, Ltd.
No. of copies: 100

February 2022

CIP - Kataložni zapis o publikaciji
Narodna in univerzitetna knjižnica, Ljubljana

338.24.021.8

JAZBEC, Saša, 1972-
Integration of structural reforms and fiscal frameworks in economic reform programmes / [authors Saša Jazbec and Janez Šušteršič in cooperation with Merdža Handalić Plahonjić ... et al.]. - Ljubljana : CEF, 2022. - (Project Strengthening line ministries’ capacities to assess fiscal implications of structural reforms (FISR project))

ISBN 978-961-6624-08-4
COBISS.SHD 99602691

The findings, interpretations and conclusions expressed in this publication serve as an open learning source. They do not necessarily reflect the views of the CEF or the European Union.

Copyright © CEF, 2022. All rights reserved.

LIST OF ABBREVIATIONS

| | |
|------|---|
| ALB | Albania |
| ALL | Albanian lek |
| BIH | Bosnia and Herzegovina |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| ERP | Economic Reform Programme |
| EU | European Union |
| EUR | Euro |
| FBIH | Federation of Bosnia and Herzegovina |
| FF | Fiscal framework |
| FISR | Strengthening Line Ministries’ Capacities to Assess Fiscal Implications of Structural Reforms project |
| GDP | Gross domestic product |
| IPA | Instrument for Pre-Accession Assistance |
| IT | Information technology |
| KM | BIH convertible marka |
| KOS | Kosovo* |
| MAK | North Macedonia |
| MNE | Montenegro |
| MoF | Ministry of finance |
| MTBF | Medium-term budget framework |
| PFM | Public financial management |
| PSB | Presidency of Strategy and Budget |
| RDI | Research, development and innovation |
| RS | Republic of Srpska |
| SDG | Sustainable Development Goal |
| SME | Small and medium-sized enterprise |
| SR | Structural reform |
| SRB | Serbia |
| TGNA | Grand National Assembly of Turkey |
| TL | Turkish lira |
| TUR | Turkey |
| VAT | Value added tax |
| VET | Vocational education and training |
| WB | Western Balkans |

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

EXECUTIVE SUMMARY

Economic Reform Programmes (ERPs) are considered **the backbone of macroeconomic and fiscal programmes** of the European Union (EU) candidate and potential candidate countries. Structural reforms (SR) are at the center of ERPs because they address the main challenges and obstacles to growth of an individual economy. If described well, costed duly and incorporated both in the medium-term fiscal framework and the annual budget, SRs stand a good chance of increasing long-term growth and/or competitiveness, or improving some other targeted segment of the economy.

In practice, challenges of **integrating the SRs outlined in ERPs into fiscal frameworks** (FF) are still present. FFs often do not provide for a sufficiently clear link with the proposed SRs or with the corresponding budget allocations, while also lacking details on the expenditure plans. There is room for improvement in providing consistent, complete and sufficiently detailed presentation of fiscal data by using a thorough assessment of SRs.

With the aim of providing systematized, comparable and merit-based assessment of the level of integration of SRs and FFs in ERPs, the CEF initiated the formulation of this publication in July 2021. The publication describes the quality of the link between SRs outlined in Chapter 5 and FFs in Chapter 4 of the ERP. Driven by the objectives and mandate of the Fiscal Implications of Structural Reforms (FISR) project, the assessment in this publication focuses predominantly on analyzing the ERP Chapter 5. The publication is based on seven case studies that describe the specifics of ERP preparation processes in: Albania, Bosnia and Herzegovina (BIH), Kosovo*, North Macedonia, Montenegro, Serbia and Turkey. They are based on the analysis of the ERPs for the period of 2021–2023. The publication does not include analysis of national budgets or any other national fiscal documents.

To ensure their consistency and comparability, the case studies have been prepared in line with **the template and the methodology for assessing the level of**

integration of SRs into FFs (see Section III and Annexes to this publication). **The theoretical explanation** of the interrelation between SRs and FFs (see Sections I and II) is aimed at ensuring a common understanding of the key concepts assessed in this publication. Building upon the results and observations from the methodological assessment (Section IV) of the seven case studies (Section VI), this publication also proposes possible improvements to the integration of SRs and FFs.

The **key obstacles to growth are similar across the region** and are **recurring from year to year** (from ERP to ERP), suggesting that they are resilient and need several years to be properly addressed. Simultaneously, this also implies that these obstacles may have not been addressed by the most effective tools or in the most efficient ways. The principal obstacles are related to **business environment in a broad sense (competitiveness, regulatory framework, energy, transport, agriculture, industry, services)** while six out of the seven case studies outline obstacles related to areas of **informal economy, education and skills**, as well as the **labor market and employment**. The **Covid-19 pandemic**, although not explicitly mentioned in all of the ERPs in the key obstacles section, has undoubtedly been a common key challenge across the region. Interestingly enough, **demographic trends** and **access to finance** only seem to be perceived as key challenging areas in two of the analyzed case studies.

The analysis covered in this publication puts **SRs at the center of the ERP**. It assesses their adequacy to **address the main obstacles** and whether they are **described clearly, costed duly and incorporated into FFs and annual budgets**. The **assessment results** of the level of integration of SRs and FFs outlined in the case studies **vary substantially**. In some cases, the information provided in the relevant ERP chapter does not mention that any SR would be considered as important for the implementation of the fiscal strategy, others imply vague links, whereas some outline a **clear link between mid-term planning and numerous SR measures** in the ERP.

The diverse quality of SR presentation, in terms of their link with the identified obstacles, clear definition of activities, and integration with the FF (via costing and budgeting), is confirmed by an assessment analysis using the **SR integration scoreboard** developed for this publication. Based on the results of the scoreboard and the analysis of FFs, the seven ERPs can be divided into three broad groups:

1. ERPs with advanced integration between SRs and FF
The ERPs of Kosovo* and North Macedonia both received 90% of possible points in the scoreboard. Their ERPs start with a clear note about the key or sectoral challenges to be addressed, while further elaboration of the reforms and related activities vary in terms of clarity, consistency and incorporation of all the necessary aspects. The FF of ERP of North Macedonia refers to activities of some SR measures and provides an extensive list of capital investment projects, which can be linked to the areas of SRs and individual measures. The FF of ERP of Kosovo*, despite references to the reduction of the informal economy and the four measures assessed for their economic impact, fails to address or refer to the overall positive impact of the reforms or the fiscal space needed to fund them. In both ERPs, the Ministry of Finance (MoF) ensures consistency between planned budgetary funding for SR measures and budget allocations in the annual budget and the medium-term budget framework (MTBF) document.

2. ERPs with notable integration between SRs and FF
The ERPs of Serbia, Montenegro, Albania and Turkey received 60–75% of possible points in the scoreboard. In their respective case studies, the experts highlighted key areas for improvement in the presentation of SR measures.

3. ERP with insufficient integration between SRs and FF
The ERP of BIH received less than 50% points in the scoreboard. Many SR measures, their costs and sources of funding are not clearly defined. The definition of activities is generally less clear than in other ERPs. On the other hand, there are several good examples

of SR measures but they are often not presented equally well for all government levels implementing the measure. In the FF, some of the measures can be identified but explanations of changes in budget items are weak and insufficient. It has to be noted that the insufficient integration of SRs and the FF is at least partly the consequence of the difficulties related to the coordination and consistency of the ERP document in the specific constitutional structure of BIH, where competencies for most reform areas and the fiscal policy are assigned to subnational levels of government.

Based on the assessment results, the last section of this publication points out possible improvements to the process of integration of SRs into FFs. The main challenge seems to be **improving how the ERP FF in Chapter 4 refers to and incorporates the SR measures of Chapter 5**. The key to the costing of SRs and their integration into FFs is **clear definition** of a reform and its activities, implying the importance of a narrative. The best results seem to be achieved when the MoF is closely involved in the costing and budgeting of SR measures, and where the availability of budget financing is a precondition for the measures to be included in the ERP. Improvements can be made simply by **better presenting the already existing links between the budget and SR measures**.

Finally, **improving the overall consistency of the ERP document requires a more holistic and coordinated approach** to the development and drafting of the document. Better coordination is needed at all levels: (1) within line ministries (between program departments and the finance department); (2) between line ministries and other institutions involved in the design and implementation of SR measures according to their competencies; (3) between line ministries and the MoF, (4) between the ERP coordinator and relevant stakeholders at different levels of government, and (5) between the ERP working group and government level decision-makers. **High-level officials, coordinators and sub-coordinators should communicate more frequently during the process of SR prioritization and ERP drafting**.

THEORY BEHIND STRUCTURAL REFORMS AND FISCAL FRAMEWORKS

Economic governance has become one of the key aspects of the EU enlargement process over recent years, mirroring moves in the EU to strengthen economic policy coordination and surveillance under the European Semester. It involves reforms needed to foster macroeconomic stability, deliver fiscal sustainability, and support long-term growth and competitiveness. The focus on fundamental reforms, including those related to the economy, was further reinforced in the enlargement methodology adopted by the European Commission (EC) in 2020.

In the same vein, the Economic and Financial Dialogue between the EU and the Western Balkans (WB) and Turkey has since 2015 provided targeted policy guidance. This dialogue is based on medium-term ERPs submitted annually by all candidate countries and potential candidates. The ERPs include macroeconomic and fiscal policy frameworks as well as SRs to boost competitiveness and long-term growth.

Not just emerging economies but many advanced countries need SRs to make their economies more productive and raise the welfare of the inhabitants. **SRs** improve the way governments are run, and they help boost employment, encourage business start-ups, and raise productivity. For example, reforms in product and service markets, such as deregulation in industries like energy and transportation, can boost competition among firms. Reforms in labor markets, such as lower employment taxes and changes to unemployment benefits, can help workers join the labor force and find jobs. Some of these reforms may entail short-term economic and social costs, and often face strong political opposition.

Reforms do not merely contribute to economic growth but can also importantly impact on the level of public debt burdens over time. Because reforms tend to boost growth, combining reform packages in a consistent policy mix with revenue increasing measures as well as temporary fiscal support in the form of spending on high-return projects or tax incentives may reduce a country's debt burden over the medium term. However, for

countries to consider such packages, they need to balance the revenue-expenditure mix with the view of the current fiscal position, a robust medium-term FF, and credible political commitment to major reforms.

FF refers to the country's overall fiscal policy strategy, including the medium-term fiscal path. Fiscal policy objectives should fit into the broader context of the overall economic policy framework in the recovery context.

FF includes the structure and efficiency of public finance revenue systems as well as the composition and effectiveness of public finance expenditure and debt trajectory. Being a dynamic category, the FF incorporates the planned discretionary fiscal short-term measures and medium-term budgetary framework changes, stemming from SRs and other measures. The big picture of the FF also includes the estimation of the cyclical and structural position of the economy in relation to the fiscal balance.

Most candidate and potential candidate countries have some form of legally mandated fiscal rules. Strict formulation and application of legal fiscal rules may limit the broader scope of SRs, as reforms can induce short-term fiscal costs. If reforms are expected to improve public finances in the long run, they should be viewed in the mid- or long-term perspective and as such, they are compatible with a more flexible formulation or interpretation of the legal framework. As short-run output losses of reforms are alleviated by a fiscal stimulus, long-run output gains from reforms imply that fiscal viability can be reached within a mid-term period, depending also on the economic cycle.

Product market reforms are generally more acceptable than labor market reforms, as they have a large impact on fiscal revenues and are politically more acceptable. The design and interpretation of legal fiscal regimes should account for the interdependency between the fiscal policy and structural economic policies and as such, provide for some flexibility (with regard to the economic cycle, one-off expenditures, mid-term effects of SRs, etc.).

By design, fiscal rules are established with the aim to constrain public expenditures and the room for policy discretion, for which there are sound economic reasons, among them the need to prevent politically motivated but costly measures and to ensure long-term fiscal sustainability in the face of, inter alia, demographic changes. However, strict application of fiscal rules may be counter-productive in cases where economic policy measures may improve the fiscal stance in the long term, the short-term fiscal burden notwithstanding. This applies particularly to two instances: (1) public investment may stimulate growth and thus improve the debt-to-GDP ratio, while giving rise to numerous issues regarding the nature of investment, the size of the debt-reducing effect, and crowding-out of private investment, (2) SRs are claimed to be necessary to foster growth, while less attention has been paid to their fiscal implications.



CONSISTENCY OF THE ECONOMIC REFORM PROGRAMME

Why is the consistency of ERP components needed in the first place? Very simply,

- if a country has SRs that do not address the main obstacles to growth or
- if it has SRs that are clearly defined but does not provide funds to finance them, or
- if it defines the necessary SRs but does not include them in the multi-annual FF,

then the progress needed in economic governance will simply not take place and the ERP will lack a crucial component – its implementation.

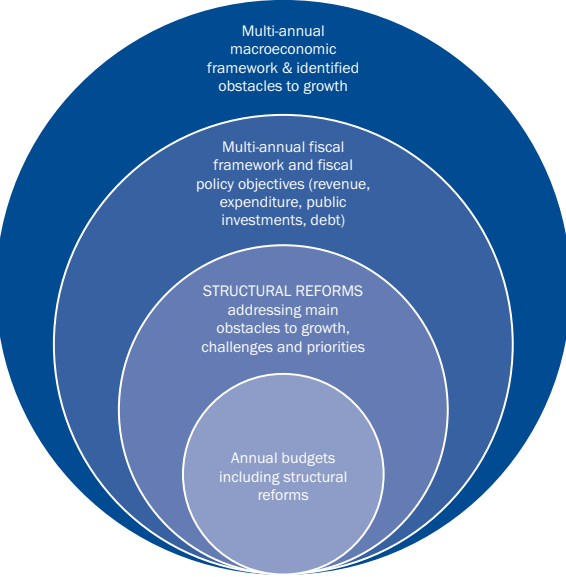
In practice, challenges of **integrating the SRs outlined in the ERPs into FFs** are still present. FFs often do not provide for a sufficiently clear link with the proposed SRs, or with the corresponding budget allocations, while also lacking details on the expenditure plans. There is room for improvement in providing consistent, complete and sufficiently detailed presentation of fiscal data by using a thorough assessment of SRs.

On a more general note, there is a need for improved coordination of economic policies recognizing the interdependent nature of the fiscal policy and structural economic policies. Institutional arrangements should reflect that the enforcement of fiscal discipline should not be pursued as a short-term objective per se but rather incorporate the positive long-term fiscal effects associated with sound structural policies.

Consistency of the overall ERP turns out to be one of the most important imperatives because it contributes to the ERP's credibility, improves its implementation odds,

and increases its effectiveness. To ensure to ensure consistency, spending priorities in the fiscal chapter must be aligned with the SR priorities or discrepancies explained. Prioritization of SRs must address the main challenges identified, while at the same time reflect and recognize prudent fiscal policy through existing fiscal rules and limited resources. Finally, the financial planning framework should ensure the financial feasibility of reforms.

Figure 1. Links between macro framework, multi-annual FF, SRs and budget framework



1. OVERALL POLICY FRAMEWORK AND OBJECTIVES = STRATEGY (INCLUDING DIAGNOSTICS)

The starting point of the ERP document is the overall strategy, which should describe the country's **key economic challenges / obstacles to growth** (these days particularly in light of the recovery from the Covid-19 crisis), and the **current policy framework for the medium term**, and spell out the **main policy objectives** embedded in that framework. Countries are encouraged to include cross-references to the EC's assessment of the previous ERP (the section on key structural challenges and reform priorities). In this part, a concise overview of the measures taken or planned to be taken over the duration of the programme should also be presented.

It is advisable to also take notice of the joint conclusions of the annual Economic and Policy Dialogue, the so-called "country-specific policy guidelines". Every year since 2015, the Economic and Financial Dialogue between the EU and the WB and Turkey has adopted targeted policy guidance for all partners in the enlargement

region. The guidance represents the participants' view on the short-term policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the policy guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. The EC evaluates the implementation of the policy guidance in the following year's ERP assessments.

Recently, there has been a bigger focus on the environmental, social and governance criteria, which means that Sustainable Development Goals (SDGs), Green Deal goals and digital transformation goals should also be connected to the country's strategy. This will make consistency of the needed elements even more challenging. To help countries overcome this, the EC has prepared a visual presentation of links between reform areas and relevant policy documents that should be considered in the table of Annex 2 to the ERP 2022–2024.

| Reform measures ERP 2022–2024 | Key structural challenges (EC assessment of ERP 2021–2023) | ERP Policy Guidance 2021 | Enlargement Package 2021 | SDGs 2020–2030 | European Green Deal / Green Agenda for the WB | European Digital Agenda / Digital Agenda of the WB | Instrument for Pre-Accession Assistance (IPA) III projects supporting this reform |
|-------------------------------|--|--|--|---|--|--|--|
| Measure X: | This box should mention specific key structural challenge(s) from the ERP 2021–2023 Assessment which the measure aims to tackle. | This box should mention if/how this SR addresses any ERP Policy Guidance 2021. | This box should mention if/how the reform measure addresses any policy recommendation from the Enlargement Package 2021. | This box should mention the relevant SDGs 2020–2030 and a short description of how the measure contributes to achieving the SDG(s). | This box should mention how the reform measure addresses the goals of the European Green Deal / Green Agenda for the WB. | This box should mention how the reform addresses the goals of the European Digital Agenda / Digital Agenda for the WB. | This box should feature a list of relevant IPA III project(s) supporting this reform measure (title, amount & year). |

2. MACROECONOMIC AND FISCAL FRAMEWORKS

The sections on **medium-term macroeconomic and FF and SRs** (ERP Chapters 3, 4 and 5) should be consistent with the above-mentioned measures implementing the policy guidance, and should refer back to them and their expected impact where appropriate.

Macroeconomic framework starts with an overview of the programme's expectations, including the developments of the world economy and main (regional) economic partners, and other components of the country's macro development. It focuses on the key economic aggregates of the real sector (output, consumption, investment, employment, productivity, wages), financial markets (inflation, monetary and credit variables as well as the exchange rate) and the external sector.

Apart from the basic macroeconomic scenario, alternative macro scenarios, stemming from different domestic and

external risks, fiscal risks or imperfect implementation of reforms, are assessed and presented in the ERP.

FF refers to the country's overall fiscal policy strategy, including the medium-term fiscal path. Fiscal policy objectives should fit into the broader context of the overall economic policy framework in the recovery context.

FF includes the structure and efficiency of public finance revenue systems as well as the composition and effectiveness of public finance expenditure and debt trajectory. Being a dynamic category, FF incorporates the planned discretionary fiscal short-term measures and MTBF changes, stemming from SR measures, including permanent (structural) fiscal policy measures. It also includes the estimation of the cyclical and structural position of the economy and the budget balance, as well as the analysis of the long-term sustainability of public finance.

3. STRUCTURAL REFORMS, THEIR COSTS AND FINANCING

This section gives an overview of the **main structural obstacles to competitiveness as well as sustainable and inclusive growth** at national level. It also proposes a **set of SRs** aimed at addressing the main challenges identified in the analysis. The ERP is expected to provide a comprehensive analysis of the whole economy, divided into eight areas (thirteen areas as of the ERP 2022–2024 Guidance Note).

The SRs should be clearly defined, with specific activities planned in the following three years. Two to three countrywide or sectoral results indicators should be chosen for monitoring and evaluating the results of each reform measure on specific segments or sectors in

the economy. The expected impact on competitiveness as well as on social outcomes and the environment should be estimated. The main risks that may affect the implementation of the measure should be identified and the actions planned to minimize the risk or to mitigate its effects should be listed. Last but not least, the costs of the measures (additional costs as opposed to the costs “before the reform times”) should be estimated and sources of financing determined (Tables 10a, 10b). When examining the expenditure items in the state/local budgets for the relevant years, the SR costs should be included in the budgets if they affect the expenditure side. The revenue side of the budgets should be affected if the SRs are of the revenue nature.



ASSESSMENT METHODOLOGY

For the purpose of this publication, an assessment methodology was designed to determine the level of integration of SRs and FFs in ERPs. To make the analysis of case studies as comparable as possible, and to address the risk of subjective interpretation which comes with any qualitative assessment, the methodology was jointly developed in consultations between the group of the FISIR project experts and the CEF. The case studies are based on the analysis of the last ERP available at the time of preparation of this publication (ERP 2021–2023).

To keep the assessment tractable, the following methodological limitations were imposed:

- As the analysis was intended to assess the consistency of ERPs as self-standing documents, it **focused on the ERPs without looking at secondary sources**, such as national documents presenting the FF (annual budgets, MTBFs) or national policy documents related to the areas of SRs covered by the ERPs
- Assessment **did not include analyzing the macroeconomic outlook** and its consistency with the FF and SR components of the ERP
- The most **thorough examination was applied to the SR chapter**, given that it was the focal point of the FISIR project
- The analysis of the FF was limited to how well the **link between the budget outlook and the financing of SRs** was established and explained.

Two methodological tools were developed to support the drafting of case studies and their comparability: a **template for case studies** and a **SR integration scoreboard** for a thorough assessment of each SR measure. The template and instructions for scoring are annexed to this publication.

The template asked the experts to focus their analysis of the ERPs on these key guiding questions:

- What are the key obstacles to growth identified in the ERP and how well are they justified?
- What are the key features of the ERP's fiscal strategy and how are the SRs incorporated in it?

- How clearly are the SRs presented and linked with both the key obstacles and the FF?

The SR integration scoreboard required the experts to assess each SR measure according to four questions:

- Is it clear which key or sectoral obstacle the reform is addressing?
- Are the reform and its activities clearly defined?
- Is the reform fully costed?
- Is it clear from which budget line, program or institutional budget the budgetary funding for the reform will be provided (not relevant for SR measures funded exclusively by non-budgetary sources)?

It has to be noted that the last question goes beyond the requirements of the ERP Guidance Note. The Guidance Note requires to state the amount of budgetary funding planned for each SR measure by years, without explicitly asking to specify the source of funding in more detail. In our opinion, adding such information to the ERPs would increase the credibility of claims that the funding of SRs is already planned for in the budget and the medium-term fiscal planning documents.

For each of the four questions, SR measures were assigned a qualitative score (yes / no / partly), based on predefined criteria (see Annex 2). The qualitative scores were translated into numerical values, assigning 1 point for a yes, 0.5 points for partly and 0 points for a no. Given that the number of SR measures differed between ERPs, the total score for an ERP was expressed as a percentage of total points that could be awarded in the ideal case.

To ensure the consistency of scoring, the scoreboard criteria were first tested on a small number of SRs (five per ERP), discussed among all experts and further clarified. The final scoring results were checked for horizontal (between-case studies) consistency by the authors of this publication. Still, given that a degree of subjectivity is always present in such analyses and that small differences in scores may not be significant, the scoreboard results are only presented at the aggregate level of the ERPs.

IV.

MAIN FINDINGS

1. KEY OBSTACLES TO GROWTH

According to the EC's ERP Guidance Note (June 2020), there are eight main areas of SRs in the ERP 2021–2023:

1. Energy and transport market reform
2. Agriculture, industry and services
3. Business environment and reduction of the informal economy
4. Research, development and innovation (RDI), and digital transformation
5. Economic integration reforms
6. Education and skills
7. Employment and labor market
8. Social protection and inclusion

Looking at the case studies, the key obstacles to growth are similar between ERPs and are recurring from year to year (from ERP to ERP), suggesting that they are resilient and need several years to be properly addressed, while also implying that they may have not been addressed by the most effective tools or in the most efficient ways, therefore leaving the government and its officials a room for improvement.

Most of the experts conclude that ERPs contain specific key challenges that summarize the main obstacles to growth. They are clearly defined and categorized in relevant areas, and they are also largely consistent with the main challenges identified by the EC. Some experts report that some of the identified challenges are not so relevant, as they focus on smaller groups of stakeholders or processes, setting aside significant problems in important areas, or that relevant areas are addressed but touched upon too briefly.

Table 1 presents a list of key challenges / obstacles to growth identified in the ERP 2021–2023, by areas of SRs. All ERPs outline obstacles related to business environment in a broad sense (competitiveness, regulatory framework, energy, transport, agriculture, industry, services), and most (6 out of 7) face obstacles related to the informal economy, education and skills, the labor market and employment. The Covid-19 pandemic, although not explicitly mentioned in all of the ERPs in the key obstacles section, has undoubtedly been a common challenge in WB and Turkey. Interestingly enough, demographic trends and access to finance only seem to be perceived as key challenging areas in two of the analyzed ERPs.

Table 1. Key challenges/obstacles identified in the ERP 2021–2023

| | ALB | BIH | KOS | MNE | MAK | SRB | TUR | Total |
|---|-----|-----|-----|-----|-----|-----|-----|-------|
| Business environment / competitiveness / regulatory framework | x | x | x | x | x | x | x | 7 |
| Informal economy | x | | x | x | x | x | x | 6 |
| Limited access to finance | x | x | | | | | | 2 |
| RDI | x | | | | | x | x | 3 |
| Education and skills | x | | x | x | x | x | x | 6 |
| Labor market and employment | x | x | x | x | | x | x | 6 |
| Social protection | x | x | | | | x | x | 4 |
| Demographic trends | | x | | x | | | | 2 |
| Covid-19 pandemic | x | | x | x | x | x | | 5 |

2. FISCAL FRAMEWORKS AND INCLUSION OF STRUCTURAL REFORMS

In this section, the key features of the ERP's fiscal strategy and FF for the next three years should have been analyzed and most importantly, references to SRs should have been identified, along with specific information about which reforms are referenced and how. This section thus provides the experts' observations /comments on how well the fiscal strategy and framework incorporate at least some of the SRs. The observations are summarized below and differ substantially.

Albania: Fiscal consolidation and the decreasing trajectory of public debt are the main orientation of the fiscal strategy in 2021–2023 with a new fiscal rule in place (the primary budget balance cannot be negative), while keeping public investment at a constant level of 4.8% of GDP, including support for the energy sector (possible link with a SR). Some SRs seem to be included on the revenue side of the FF, especially raising revenue as a consequence of improving fiscal administration and fighting the informal economy. While possibly some SRs are included, the county case study concludes that information provided in the relevant ERP chapter does not mention the fact that any SR would be considered as important for the implementation of the fiscal strategy.

Bosnia and Herzegovina: Fiscal stabilization (the primary surplus, keeping consolidated spending below 40% of GDP) at all government levels is considered the major factor in overall macroeconomic stability, along with strengthening economic activity and competitiveness. The case study states that there are no references to structural measures in the FF chapter, neither on the revenue nor on the expenditure side. The significant increase in subsidies could be related to individual SR measures but the link is not sufficiently described. Substantial amounts of “other transfers” are planned as an intervention measure against Covid-19, which is not explicitly mentioned as a key obstacle at all. The presented fiscal strategy focuses on recovery after Covid-19 (fiscal stabilization) but does not include medium-term reforms that make the recovery sustainable. There is no financial space to support the implementation of investment projects.

Kosovo*: The goals of FF are to ensure economic recovery after the pandemic and strengthen the overall fiscal position (respecting fiscal rules that were temporarily breached due to Covid-19). Success depends on the implementation of ERP reforms: increasing voluntary tax compliance and reducing informality on the revenue

side, while the expenditure side is connected also to a few specific ERP measures (energy efficiency, establishment of a commercial court, and increased employment as a result of targeted training of the unemployed). Other SRs besides reducing the informal sector are not mentioned as important in the fiscal strategy; at the same time, they are not assessed as having a large fiscal impact due to their cost. The section also fails to explain how the fiscal space needed for funding SRs has been or will be created.

Montenegro: The main features of the FF are (1) increased public debt due to Covid-19 (highest at 104% of Gross Domestic Product (GDP)), (2) reduction in public spending in the mid-term due to completion of highway works, (3) ambitious fiscal goals (budget surplus in 2023, reduction of public debt to 69.9% of GDP by 2023). Although the SR chapter of the ERP follows the given structure, addressing the key challenges and budgeting the costs of each measure individually, the FF chapter does not clearly and adequately present the impact of SRs on public finance. Some chapters analyze the effect of planned measures on public revenues but do not fall within the scope of SRs. Tables 10b contain clear sources of financing SR measures in 2021 but the amounts are not analyzed in the FF. There is no mentioning of the possible impact of SR measures on public spending, competitiveness and public revenue growth. There is no direct link between the analysis of public debt and the impact of SR measures on debt development. There are some indirect links between the SRs and the FF in Subchapter “Medium-term macroeconomic scenario”.

North Macedonia: The main platforms of the FF are (1) Smart Growth 2021–2025 for recovery and sustainable development, (2) Fiscal Consolidation 2021–2025, and (3) Public Investment Plan 2021–2025. There is a clear link between mid-term planning and numerous SR measures from the ERP. The SRs have been well incorporated into the FF, as the procedure for incorporation of a measure into ERP is conditioned with ensured finances. The mid-term FF also mentions specific measures (at least half of SRs), indicating stable planning of funding for the measures. Execution of current budgets is still Covid-19 related, which could imply certain reallocation of finances.

Serbia: The main public policy strategy envisages gradual stabilization of public finance (reduction of general government debt to 56% of GDP in 2023 through favor-

able fiscal balance and redesign of fiscal rules). Projections of fiscal aggregates in 2021–2023 are based on projections of macroeconomic indicators, planned tax policy which implies further harmonization with EU laws and directives, and fiscal and structural measures, including further reform of large public companies. However, there is no direct link between specific ERP measures and their sources of funding, and the links with the FF are rather vague if they exist at all. There is no explicit connection between structural balance and SRs, and the only reform that is explicitly mentioned in the Quality of Public Finance section is the transformation of the Tax Administration.

3. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

The quality of the presentation of SR measures in terms of their links with the identified obstacles, clear definition of activities, and integration with the FF (via costing and budgeting) was assessed by using the SR integration scoreboard developed for the purposes of this publication.

Most SR measures (81%) were found to be well linked to the key or sectoral obstacles identified in the ERP. As for other measures, the sectoral obstacles were not well identified (for example, there was a long list of obstacles without any prioritization, or a presentation of relevant data but without a deeper analysis, or some unaddressed key issues of the sector). In a few cases, the measures did not seem to address the identified obstacles but other issues in the sector, which were explained in the measure description.

The majority of SR measures (54%) were found to be supported by clearly specified activities. Where difficulties occurred, these were related to activities lacking a clear specification of the content, scope, extent, planned output or the institution responsible for implementation. Some activities were too broad, i.e. phrased as measures or objectives rather than activities, or they were mixed with other information, such as developments in the past and data. In some cases, the same activities were repeated for all three years of implementation, raising the question whether the SR measure is indeed a reform with a clearly defined timeframe or rather a continuous government activity. In other cases, activities for outer years were not specified, as these would depend on an action plan or another document to be produced during the first year of implementation. Nevertheless, the fact that more than 91% of the SR measures were assessed as having activities at least partly indicates that improvements in this area can easily be made in the future.

Turkey: The main objective is to protect the strong and sustainable structure of public finance with prudent policies on the revenue and expenditure side, as well as the borrowing policies and public financial management (PFM) and auditing. Transition to the program budget structure which was introduced by the 2021 central government budget law, is seen as an important tool to improve the quality of public finance. However, there is no further information about the budget programs in the FF of the ERP, or the SRs. Budget programs with detailed descriptions and costing at the sub-program level would pave the way for the establishment of a clear link between the SRs and the FF, which currently does not seem to exist.

Only half of the SR measures were assessed as fully costed, and further 29% as at least partly costed. The main weaknesses identified were the lack of information linking cost estimates with costly activities (cost drivers), as the narrative explanation often focused on the funding sources for the SR measure and not its costs, and inconsistencies between the narrative and the costing tables. Often the costs were not distributed by years or not provided for all years of implementation, even when activities were planned for all years. In some cases, experts were concerned that the costs were underestimated or did not cover all the planned activities. The current update of the BIH ERP did not include Annex tables on costing and funding.

Regarding financing, **the source of budget funding was clearly identified for half of the SR measures.** This result is strongly driven by three ERPs (Kosovo*, North Macedonia and Serbia) where the experts were aware of the practice that the MoF approves the consistency of SR funding with fiscal planning documents before SR measures are included in the ERP. As detailed information on the sources of budget funding is not currently required by the ERP Guidance Note, it may well be that in others funding for SR measures is also at least partly secured within relevant MTBF ceilings of budget users or programs; however, this was not clearly stated in the ERP document.

Considerable differences between individual ERPs were identified. Based on the results of the SR integration scoreboard and also taking into account the narrative assessments of the FFs, the seven **ERPs can be divided into three broad groups.**

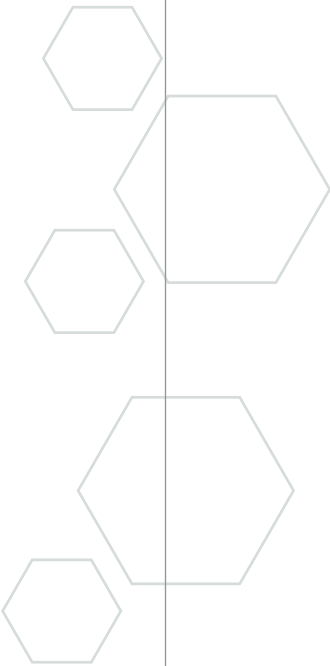


Table 2. Structural reforms integration scoreboard

| Level of integration between SRs and FF | Scores (% of all points) | FF related to SRs | ERPs |
|---|--------------------------|--------------------------------|---|
| Advanced | Around 90% | Many or some references to SRs | Kosovo* North Macedonia |
| Notable | 60–75% | Few or no references to SRs | Serbia Montenegro Albania Turkey |
| Insufficient | Less than 50% | Few references to SRs | Bosnia and Herzegovina |

ECONOMIC REFORM PROGRAMMES WITH ADVANCED INTEGRATION BETWEEN STRUCTURAL REFORMS AND FISCAL FRAMEWORK

The ERPs of North Macedonia and Kosovo* both received 90% of possible points in the SR integration scoreboard. Specifically, in the ERP of North Macedonia, the elaboration of SR measures starts with a clear note on the key or sectoral challenges to be addressed, while further elaboration of the reforms and related activities vary in terms of clarity, consistency and incorporation of all the necessary aspects. Similarly, the majority of SR measures in the ERP of Kosovo* were assessed as well defined with a clear linkage to the key challenges that they address, with specific activities that are costed and have a budget funding line.

The FF of the ERP of North Macedonia refers to activities of some SR measures and provides an extensive list of capital investment projects, which can be linked to the areas of SR and individual measures. The FF of ERP of Kosovo*, on the other hand, despite references to the reduction of the informal economy and the four measures assessed for their economic impact, fails to address or refer to the overall positive impact of reforms or the fiscal space needed to fund them. In both ERPs, the MoFs ensure consistency between planned budgetary funding for SR measures and budget allocations in the annual budget and the MTBF document.

ECONOMIC REFORM PROGRAMMES WITH NOTABLE INTEGRATION BETWEEN STRUCTURAL REFORMS AND FISCAL FRAMEWORK

The ERPs of Montenegro, Serbia, Albania and Turkey received 60–75% of possible points in the SR integration scoreboard. In their case studies, the experts highlighted key areas for improvement in the presentation of SR measures.

Regarding the ERP of Montenegro, the expert emphasized that the analysis of obstacles was not comprehensive and consistent enough to show the real challenges of the economy and society. On the other hand, costing of SR measures provides a solid basis to be qualitatively incorporated into the FF and economic growth projections. But in order to achieve better consistency and quality of the ERP, coordination on higher government levels and in the MoF is needed, with more frequent communication between high-level officials, coordinators and sub-coordinators during the entire process of ERP drafting. A holistic approach, starting from the identification of obstacles to the clear incorporation of the costs of SR measures into the FF, was found missing.

In the Serbian ERP, SR measures were generally assessed as addressing the key obstacles very well and being mostly fully costed. However, the key obstacles are presented in a very narrow sense, while the relevant section rather elaborates on the progress and achievements made in the past than the impact of the measure in the future. In some areas, such as social protection and health care or the labor market, it seems that significant challenges affecting large groups of population have been overlooked.

The analysis of key obstacles in the Albanian ERP was assessed as clearly related and consistent with the overall policy framework, with the proposed SR measures well chosen to tackle the obstacles. The main weakness was found in the costing and budgeting of SR measures, which was often unclear and incomplete.

For the Turkish ERP, clear definition of activities and exact estimation of their costs were highlighted as the main challenges. More precision on the sources of budget funding will be possible based on the recently introduced

program budgeting. The obstacles identified in the ERP were assessed as relevant but, in some cases, their presentation lacked clarity and well-structured approach.

The FFs of the Turkish and Albanian ERPs include no references to SR measures. In the Serbian and Montenegrin ERPs, the references are scarce and sporadic. In Serbia, only 14% of the total funding for SR measures is planned to be allocated from the central budget, which may be the reason why the transformation of the Tax Administration is the only SR measure explicitly mentioned in Chapter 4, a few others indirectly indicated when discussing the allocation of fiscal space and the quality of public finance. The fiscal chapter of the Montenegrin ERP provides a list of development projects but although some of these could be related to SR measures, no explicit reference is made. The expert also noted that the medium-term macroeconomic scenario of the ERP includes a much clearer but still an indirect link between the FF and SRs.

ECONOMIC REFORM PROGRAMME WITH INSUFFICIENT INTEGRATION OF STRUCTURAL REFORMS AND FISCAL FRAMEWORK

The ERP of BIH received less than 50% of possible points in the SR integration scoreboard. Many SR measures, costs and sources of funding are not clearly defined. The definition of activities is also generally less clear than in other ERPs. On the other hand, there are several good examples of SR measures but often not presented equally well for all levels of government implementing the measure.

In the FF, some of the measures can be identified but explanations of changes in budget items are weak and insufficient. There is room for improvement in providing a consistent, complete and sufficiently detailed presentation of fiscal data, using other available documents related to the budget framework, investment programs, the status of available funds on loans and projects implemented by international organizations. A fiscal strategy including these amendments could support the expected activities defined by SRs.

It has to be noted that the insufficient integration of the SRs into the FF is at least partly the consequence of the difficulties related to coordination and achieving consistency of the ERP document in the specific constitutional structure of BIH, where competencies for most reform areas and the fiscal policy are assigned to the subnational levels of government.



POSSIBLE APPROACHES TO IMPROVEMENT

The assessment results indicate that the main challenge seems to be **improving how the FF in ERP Chapter 4 refers to and incorporates the SR measures of Chapter 5**. The FF should clearly explain how the funding for SR measures that require substantial budget resources is provided for in the adopted budget and the medium-term fiscal planning document. It should also explain whether and how the economic impact of SR measures and their potential revenue effects are taken into account.

This goal has not yet been fully achieved by any ERP. The best results seem to be achieved in ERPs where the MoF is closely involved in the costing and budgeting of SR measures and where the availability of budget financing is a precondition for the measures to be included in the ERP. Here improvements can be made by simply **better presenting the already existing links between the budget and SR measures**.

In some ERPs, the FF includes a presentation of the main investment or development projects. This information could easily be linked to SR measures supported by such projects. When program budget approach is used for setting the expenditure ceilings, adding also the information on budget programs or subprograms, which include allocations for the implementation of SR measures, would be beneficial. Information from programming documents related to IPA and other international assistance supporting SR measures could also be included in the presentation of the FF.

Another important challenge identified in the assessment was the **insufficiently clear and concise presentation of the activities of SR measures**. Some ERPs (Serbia, North Macedonia) present activities in a tabular form. This is a good approach to achieve rigor and focus in how the activities are formulated. A verifiable planned output and the responsible institution should always be included for each activity to improve clarity and support monitoring of the implementation.

The key to costing SRs and their integration into FFs is the clear definition of a reform and its activities, implying the importance of a narrative. A common reason for the weak specification of the activities is that some of them cannot yet be defined at the time of ERP drafting, for example because they will only be determined by an action plan or another document, which is yet to be completed. In such cases, it would seem better to include the measure only in the next ERP, when it becomes possible to plan it with more precision. On the other hand, measures with repetitive activities for all planning years, which are often rolled over from ERP to ERP and have become a part of regular government activities, should be removed from the ERP.

Despite the support provided by the FISR project, **the costing and budgeting of SR measures was still found to be unclear and incomplete in many cases.** Sometimes this is only a matter of providing a better explanation for the tables in the narrative part on costing. Some ERPs occasionally use tables to present the estimated costs separately for each activity, which is a good way to improve the clarity and reliability of cost estimates.

In many cases, unclear or incomplete costing is a direct consequence of imprecise specification of activities, or the lack of information needed to estimate the costs. There are also cases where the funding sources are not yet secured or convincingly explained in the ERP. These challenges can be addressed by providing further technical training on the presentation of activities and their costing. However, SR measures for which the costs cannot yet be estimated or the funding secured should not be included in the ERP.

Identification of key and sectoral obstacles to growth and competitiveness was generally assessed as appropriate. Some weaknesses were nevertheless noted, especially with the analysis of sectoral obstacles. Long unstructured presentations of data and long lists of obstacles should be avoided. Instead, the analysis should focus on a small number of the most important obstacles and their underlying reasons that will be addressed by the SR measures.

Finally, **improving the overall consistency of the ERP document requires a more holistic and coordinated approach** to the development and drafting of the document. Better coordination is needed at all levels: (1) within line ministries (between program departments and the finance department); (2) between line ministries and other institutions involved in the design and implementation of SR measures according to their competencies; (3) between line ministries and the MoF, (4) between the ERP coordinator and relevant stakeholders at different levels of government, and (5) between the ERP working group and government level decision-makers. **High-level officials, coordinators and sub-coordinators should communicate more frequently** during the entire process of SR prioritization and ERP drafting.

In developing the ERP, it is important to follow the proper order of steps: (1) identification of obstacles, (2) identification and prioritization of SR measures based on their expected impact, (3) planning of activities along with cost estimates and available funding. Impact assessment of SR measures, in particular a quantitative one, has been found lacking for most of the SR measures but could contribute to better prioritization and definition of the measures and related activities.



VI.

CASE STUDIES





CASE OF ALBANIA

PREPARED BY EXPERT MARSED HARIZI

1. EXECUTIVE SUMMARY

The ERP 2021–2023 of Albania is generally well-structured, including a proper analysis of sectoral areas and relevant reform measures that aim to achieve sustainable growth. On the other hand, there is still a long road to go cost-wise.

On the positive note, the analysis of the key challenges to growth is clearly related and consistent with the overall policy framework. On the downside, besides highlighting the forecasts for the main macroeconomic indicators (fiscal balance, public debt, total expenditures, public investments) aligned with the government pursuit of fiscal consolidation, it does not give any reference to a SR, nor mention the fact if any measure is considered as important for the implementation of the Fiscal Strategy.

Overall, there is a certain level of uncertainty when linking SRs with the FF, this connection is not mentioned in the ERP (and it is not obvious from the information

provided in the narratives either). The proposed reform measures are well defined and represent the ones needed to bring down the obstacles that have limited the economy, but cost-wise it is unclear if they are fully estimated or budgeted.

The main positive feature of the ERP is the establishment of an inter-ministerial working group that supervises the entire process of sectoral analysis and defining the proper reform measures needed to achieve the desired state. On the other hand, the most significant challenge of the ERP continues to be the quantitative estimations of the SRs' costs and potential impact of SRs on competitiveness.

To ensure consistency, spending priorities in the fiscal chapter must be aligned with SR priorities. The inter-ministerial working group must consider this aspect too and make the needed efforts to deliver cost estimations and channel budget allocations toward the relevant SRs.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

The key obstacles to growth, competitiveness and inclusive growth keep transferring from one ERP to another. These include informal economy, social protection, business environment, education and skills, labor and employment, and RDI. The aftermath of the 2019 earthquake still affects the recovery of the economy. Like in the whole world, the key challenges have emerged with the eruption of the Covid-19 pandemic (mainly in the sectors of tourism, trade and traveling). Informality remains a burden on the private sector, which consists primarily of micro, and small and medium-sized enterprises (SMEs). Informal businesses generally have lower productivity than formal businesses, which is a drag both on firms and on the economy.

Limited access to finance and business services for Albanian entrepreneurs remains another obstacle to growth. Low funding in universities negatively impacts their ability to conduct scientific research. Cooperation with the business community is below the potential

and there is reluctance to explore further cooperation opportunities. Another long-term challenge is inclusive education, which requires laying the foundations to ensure participation of all children with special needs. The current school system does not yet meet the standards to ensure an appropriate level of inclusion. The pandemic imposed significant challenges in the development and implementation of vocational education and training (VET) policies, as well as in the delivery of VET programs.

In conclusion, the Albanian ERP 2021–2023 outlines clearly (in a broader sense) the main challenges that affect the overall macroeconomic sustainability. The obstacles are well justified but having in mind all the sectors required to be addressed by the EC guidance, it is easy to spot that they are not too many. The challenges related to informality, limited access to finance for SMEs, education and VET have been well explained, whereas the challenges affecting the labor market have not been mentioned (or are not clear enough).

Furthermore, the ERP concentrates too much on an extensive review of the fiscal packages implemented by the government to support households and businesses, steering the focus away from the period to come. Besides, what has been identified in this year's ERP, has been acknowledged also in the last couple of years, except of course for the Covid-19 pandemic. This list of obstacles gives the perception that the challenges have been rolled over or that they have not been addressed well enough during the years.

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

The fiscal strategy and FF in the ERP 2021–2023 highlight that the medium-term fiscal policy will be oriented towards fiscal consolidation (as set out in the fiscal rules in the Organic Budget Law) and a decreasing trajectory (reduction) of public debt. In line with the latter, several fiscal adjustments have been undertaken over the years and in the 2021 ERP too.

The main operational anchor of fiscal policy will be the primary balance, which targets a surplus from 2023 onwards. A new fiscal rule was introduced in July 2020 (in line with EC recommendations) which makes it legally binding that from the budgetary year 2023 onwards the actual primary balance cannot be negative. This will lead to a reduction of the net public debt to around 68% of GDP by 2025 from about 80% in 2020.

In 2021, the overall fiscal deficit was targeted at 6.5% of GDP, and for 2022 and 2023 it is foreseen to be around 2.9% and 2.3% of GDP respectively. Primary balance, projected at -3.9% of GDP in 2021, is improving compared to -4.5% expected in 2020. In 2022, the primary balance is targeted at -0.1% of GDP and in 2023, a surplus of 0.6% of GDP is anticipated. In 2021, the total public debt is projected at about 78.6% of GDP. By the end of 2022, the public debt is expected to reduce to about 77.7% of GDP and to about 75.6% in 2023. It is intended and programmed to maintain the level of public investment at an annual average of 4.8% of GDP over the period of 2021–2023. The current fiscal balance (the difference between public investment and the fiscal deficit) already returned to positive levels as early as in 2021, at the level of 0.7% of GDP from the negative level of -0.6% expected in 2020.

Total public expenditures for 2021 are projected at ALL 587.6 billion or 34.9% of GDP, and for 2022 at ALL 568.88 billion or 31.5% of GDP. Interest expenses are

It is easy to determine that Section 1 “Overall policy framework and objectives” and Section 5.1 “Update on key obstacles to growth and competitiveness and inclusive growth” are related and consistent. Both arguments focus on the same agenda (with different perspective) since the government has made efforts to set up inter-institutional collaboration between the Ministry of Finance and Economy, different line ministries and the Bank of Albania.

projected at ALL 43.8 billion or 2.6% of GDP for 2021, and at ALL 49.4 billion or 2.7% of GDP for 2022, to cover any potential risk of interest rate hikes. Public investments for 2021 are projected at 7.2% of GDP or ALL 120.69 billion (including ALL 2.3 billion in support for the energy sector), and for 2022 at 4.7% of GDP or ALL 85.2 billion.

Revenue programming for 2021 supports the goals of the Ministry of Finance and Economy for fiscal recovery, as well as keeping the budget deficit and public debt under control. This program is based on improving fiscal administration and minimizing informality in the economy, thus supporting economic recovery as well as boosting production and exports. On the other hand, real-time transactions from business to business and then from business to consumer using an electronic system aims to increase the domestic net value added tax (VAT). VAT is expected to rise because of economic recovery, increased volume of imports, improved administration, fight against informality, and control of the chain of transactions between operators.

Planning to increase revenues from social and health insurance contributions is supported by economic recovery (increase in the number of employees), strengthening the public administration through controlling the declared salary level, and increasing the minimum wage from ALL 26,000 to 30,000 with an annual income effect of about ALL 3 billion.

The fiscal risks for 2021 consisted of (1) the extension of the pandemic situation, the estimated risk in reducing payments for taxes and contributions, (2) unforeseen financial results of companies in the financial balance sheets of 2020, (3) which may impact the payments of 2021, and (4) failure to approve the increase in the minimum wage as of January 1 and its postponement.

The highlights of all FF sections and the inclusion of SRs focus entirely on (1) macroeconomic developments, (2) fiscal overview (mainly expenditure performance), and (3) econometric calculations of the structural balance. The narrative part gives the broader intervention that the government must undertake to foster growth. It pays too much attention to the efforts of the national government in improving fiscal administration and minimizing informality in the economy, thus supporting economic recovery as well as boosting production and exports.

The information provided for all sectors does not give any reference to SRs. Neither does it mention whether any SR is considered as important for the implementation of the Fiscal Strategy.

| Section | Summary | Reference to SRs |
|---|---|--|
| 4.1 Policy strategy and medium-term objectives | Provides overall statistics on macroeconomic indicators and fiscal rules | No reference to any reform neither stating the importance of SRs in implementing the fiscal strategy |
| 4.3 Budget plans for the ERP submission year | Provides a statistical summary of the main sub-categories of budget expenditures and investment planning for 2021-2023 | No reference to any reform or stating the importance of SRs in implementing the fiscal strategy |
| 4.4 Medium-term budgetary outlook | Provides details on total revenue forecasts of the government (divided by sub-categories, e.g. taxes) and how the target will be achieved Lists the activities to be undertaken by the government per each area and the fiscal risks affecting expected tax and customs revenues | No reference to any reform neither stating the importance of SRs in implementing the fiscal strategy |
| 4.5 Structural balance (cyclical component of the deficit, one-off and temporary measures, fiscal stance) | Provides statistical calculations in estimating the: <ul style="list-style-type: none">• Potential GDP and output gap• Elasticity and budget sensitivity to output gap• Cyclically adjusted fiscal balance and assessing the fiscal policy stance | No reference to any reform neither stating the importance of SRs in implementing the fiscal strategy |
| 4.8 Quality of public finances | Provides a detailed annotation of the PFM Strategy in Albania and what the government has done to improve it | No reference to any reform neither stating the importance of SRs in implementing the fiscal strategy |

4. STRUCTURAL REFORMS AND THEIR INTEGRATION WITH THE FISCAL FRAMEWORK

The 2021-2023 ERP of Albania outlines the main macroeconomic and fiscal policies aiming to enable sustainable growth, increase employment and competitiveness, and reduce public debt. It summarizes the priority reforms measures of the government of Albania for the short-term future to increase domestic production, while fitting the fiscal policy objectives into the context of the overall economic recovery (from the pandemic and earthquake in 2019).

4.1. LINKAGES WITH KEY CHALLENGES / OBSTACLES TO GROWTH

The Albanian ERP 2021-2023 highlights 18 reform measures to tackle the true potential of the economy. Challenges / obstacles have been clearly defined for all the reform measures and linked with the sectoral

analysis. This has been prepared in collaboration between the Ministry of Finance and Economy, different line ministries and the Bank of Albania, who have contributed with reform measures in accordance with the priorities of the government as well as national and regional strategies and documents.

4.2. LINKAGES WITH THE FISCAL FRAMEWORK

The 2021-2023 ERP indicates marginal but positive progress that government officials have made with reporting this strategic document. The SRs have become more comprehensive, with proper and deeper analysis of sectoral challenges. Nonetheless, the cost estimations and sources of financing, which have been missing in the past ERPs, have improved only a little in this ERP.

In the majority of cases, the FF does not provide sufficiently (or at all) clear links with the proposed SRs or the corresponding budget allocations, while also lacking details on the expenditure plans (for specific measures). The narrative section “Estimated cost of the activities and the source of financing” provides the requested statistics only on a few occasions, which is mostly wrong however. Costing Tables 10a and 10b are in most cases incomprehensible and their reporting in 9 out of 18 measures is completely missing, while 3 out of 18 are reported wrong (the total value of Table 10a is not equal to the total value of Table 10b). As for the rest, it cannot be clearly determined whether the values are correct, since the narrative explanation gives neither a full picture of the estimated costs nor of the source of financing.

| Area of SR | Challenges / obstacles identified in the ERP 2021-2023 | Reform measure |
|--|---|--|
| Energy and transport market reform | It states the fact that electricity imports remain high and require better use of all potential / available energy sources (for the security of energy supply, in a sustainable and environmentally friendly way). Besides, it reflects the limitations that the Ministry is facing in identifying realistic key performance indicators and proper policies. | Measure 2: Diversifying energy sources through the promotion of renewable energy sources and energy efficiency improvements |
| Agriculture, industry and services | It states the fact that the Albanian tourism sector lacks basic infrastructure, people and facilities to deliver proper services. All these barriers along with poor water quality are impeding the unleash of the full potential of these sectors. | Measure 5: Better marine and maritime governance and services |
| Business environment and reduction of the informal economy | Sectoral challenges (Covid-19 related: human resource management; sources of raw materials; adapting to new technologies; limited access to finance (bank products); limited business activities; low number of advanced and scalable start-ups; limited access to finance and International Organization for Standardization’s standards for start-ups; informality) are clearly mentioned. The countermeasures to these challenges are described shortly and clearly. | Measure 8: Improving access to finance for SMEs |
| RDI and digital economy | Sectoral challenges (legal framework, investments, lack of funds for universities, broadband infrastructure) are clearly mentioned. | Measure 11: Development of the broadband infrastructure for digital economy |
| Economic integration reforms | Not clear / partially provided | Measure 12: Facilitating cross-border movement of goods |
| Education and skills | Schools still do not meet all inclusion standards, such as the number of support teachers, psycho-social services, textbooks, and disability equipment; universities should be supported to have curricula that are more adapted to the labor market; the VET system should be made more attractive. | Measure 14: Ensuring inclusion and equality in education |
| Employment and labor market | Better profiling of job seekers should be enabled through the revamped information system of the National Agency for Employment and Skills, and individual employability plans should be developed. Support should be provided to reintegrate the formerly informal workers in the labor market. | Measure 16: Improving the employability of the most vulnerable unemployed job seekers, especially those affected by the Covid-19 situation, through new and revised employment promotion programs and services |
| Social protection and inclusion | Strengthening monitoring, evaluation and capacity building in local, regional and central structures is the precondition for empowering vulnerable groups and people in need. | Measure 18: Increasing access to healthcare |



CASE OF BOSNIA AND HERZEGOVINA

PREPARED BY EXPERT MERDŽA HANDALIĆ PLAHONJIĆ

1. EXECUTIVE SUMMARY

SRs have not been fully integrated into the FF. Some of the measures can be identified in this part of the ERP but explanations of changes in budget items are weak and insufficient. It remains unclear whether the changes are the result of temporary and permanent structural activities or there is impact from other factors.

The FF is not comprehensive enough. There is lack of data on the sources of funds as well as their potential to ensure sufficiently clear links with proposed SRs or appropriate budget allocations, while they also lack details on expenditure plans. Presentation of investment is missed to connect with sustainable and inclusive growth.

There is room for improvement in providing a consistent, complete and sufficiently detailed presentation of fiscal data, using other available documents related to the budget framework, investment programs, the status of available funds on loans and projects implemented by international organizations (IPA sources and other organizations). A fiscal strategy including these amendments could support the expected activities defined by SRs.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

The introductory part of the ERP points out the fiscal goal of BIH. It refers to the realization of the primary surplus (reduction of the deficit in 2021) and keeping consolidated public spending below 40% of GDP of BIH with reduced public spending. It also states that the fiscal stability of BIH has been supported by the timely adoption of the entities' budgets compared to the delays with the adoption of the budgets on state level and in the Brcko District. The process of preparation and adoption of the ERP with appropriate steps is presented as well as the coordination activities of the national coordinator with stakeholders during the entire process.

To ensure consistency, further efforts are needed to align the spending priorities in the fiscal chapter with the SR priorities or explained differences. When examining the expenditure items in the state / local budgets for the relevant years, the SRs costs should be included in the budgets if they affect the expenditure side. The revenue side of the budgets should be affected if the SRs are of the revenue nature.

Improving cooperation and coordination in defining the priority measures and activities, and identifying the costs / sources of SRs seems like a good proposal to improve the current situation:

- within line ministries (between program departments and the finance department)
- between line ministries and other institutions involved in SRs (linked to competencies)
- between line ministries and the MoF, and
- between the ERP coordinator and competent coordinators at different levels of government in the BIH (uniform approach).

Having in mind the limitation of spending within the model of temporary financing prescribed by laws,² it is logical to emphasize the timely adoption of the budget if it is related to the indication in the ERP that the basis for growth in the medium term is consistent with the implementation of the investment policy. Apart from the fiscal target defined and presented, there is no information on the policies that will be implemented either in the entire BIH or in individual administrative units. Moreover, this part of the ERP does not include references to the EC's assessment in the BIH Annual Progress Report, although it was recommended by the EC Guidelines.

² According to the current laws dealing with budget issues at all levels in BIH, the implementation of investment projects is limited within the temporary financing, except for those that have already started if their continuation does not require new procurement.

The key obstacles to medium-term growth are listed by several sectors in all entities. In some cases, obstacles are not identified at all; e.g. in the social protection and inclusion sector only "the need to improve the social protection system" is noted for the Federation of Bosnia and Herzegovina (FBiH) or only indicative for the Republic of Srpska (RS). For some sectors, there is a long list of obstacles but it is not possible to identify which of them are new (e.g. the sector of agriculture in FBiH).

There are also good examples of explaining the obstacles, such as "negative demographic trends worsen the position of the labor market in the long run and the fiscal position and sustainability of all budget allocations, reducing labor supply and leading to an aging population".

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

The main objective of fiscal policy in BIH in the period of 2021–2023 is presented as "fiscal stabilization at all levels of government as a major factor in overall macroeconomic stability, with the strengthening of economic activity and competitiveness of the economy".

FF in the mid-term of 2021–2023. The assumptions for the 2021 fiscal projection are related to the projection of relevant macroeconomic indicators, and the growth rate of indirect tax revenues at 2.8% based on the historical seasonal collection scheme and projections of certain categories of revenues for 2020. **At the state level**, the largest adjustment is projected on the expenditure side because revenues largely depend on the Global Framework of Fiscal Balance and Policies in BIH (allocations of indirect taxes for BIH institutions in the amount of KM 780 million per year is an unchanged category for several years). The presented expenditures policy is in line with the basic goal of fiscal policy for all levels of government, but there are **no references to structural measures** at all. It is desirable to emphasize the coordinating role of the state institutions in each appropriate SR, at least in the narrative part.

The projections of total revenues in the FBiH show a slight increase of 1%, while in the RS they are projected to decrease by 1.1%. Revenues from indirect taxes in the RS are declining in contrast to the FBiH where this type of revenue is growing in 2021. An increase in social contributions is expected but also a decline in direct taxes in both entities. According to the explanations for both entities, the increase in social contributions is the result of the expected eco-

The main long-term obstacle is the "unsustainable demographic picture", as well as the cause-and-effect challenges of growth: the weaker position of the labor market due to reduction in labor potential puts the pressure on the sustainability of all budget allocations because of the aging population. Although it is defined for one entity only, this example can be applied to other cases too but needs to be improved with an appropriate definition of the cause-and-effect relationship.

In general, it is difficult to conclude whether some identified obstacles have lost their importance due to economic developments and implemented SRs compared with the previous year. The section about key challenges is inconsistently linked to the introductory part, so it is necessary to improve both, among other things.

nomical recovery. **It is not specified to which extra-budgetary funds these sources belong to.** In the FBiH, the reduction of direct taxes is explained with the possible impact of anti-crisis measures on the realization of revenues from corporate income tax ("the reduction in corporate tax payments by financial institutions because of approved moratorium on repayment of loans to legal entities and individuals affected by the pandemic", measure 9). **There are no references to other measures related to taxation** (FBiH – reducing the overall fiscal burden and preventing the erosion of the tax base and profit shifts; RS – reducing tax and non-tax benefits and simplifying procedures).

On the expenditure side, a **decrease of total expenditures** is projected in both entities in 2021, mainly due to a **decrease in the items related to the share of capital remittances for investment** in both entities (by 13.9% in the FBiH and by 42.3% in the RS). **In the FBiH, subsidies have increased significantly** (by 22.1% from 2020) to stabilize the operations of private companies and entrepreneurs (the Economic Stabilization Fund). This could be related to measures 9 and 12 but it is not sufficiently described. A special emphasis is placed on the item **"other transfers"** with the structure presented as the continuation of intervention measures to support the fight against Covid-19, including support to the economy, employment, and the health and social sectors in the FBiH. **The explanations of these items overlap in part but references to appropriate measures are still unclear.** Only sectors are mentioned – economy, energy, mining and industry, entrepreneurship, agriculture, water management and forestry – without any specific measures / activities.

Neither is it clear what the sources of these funds are: savings as a result of implementing the restricted public spending measure or available funds expected from some other sources (e.g. loans, donations)? Additionally, some of the items in this list should not be part of the intervention (e.g. “KM 11.5 million is planned for the construction of roads and as an aid to airports in the total amount of KM 9.5 million” or “as employment support, KM 50 million of funds are planned, which will be regulated by the program”). It is not possible to identify temporary and permanent allocations per measures / sectors. **In the RS, a decrease of subsidies is projected** (by 38.3% from 2020). The reduction of the allocation to assist the economic subjects from the Compensation Fund is explained with “a gradual end to the pandemic is expected during 2021” as well as with a reduction in investment, including less financial resources to support the Health Insurance Fund.

Interest payments are expected to increase in both entities (by 12.3% in the RS and by 26% in the FBIH) as well as **compensations for public employees** in 2021. Legal obligations are the reason for increasing the mentioned expenditures in both entities. A new organization, the Child Protection Fund, is planned to be established in the RS (SR 18) but no connection with the SR is mentioned.

For the period of 2022–2023, revenue projections have been made with the assumptions of an expected recovery during 2021, positive macroeconomic forecasts and growth rates of indirect tax revenues (3.5% in 2022 and 3.7% in 2023) for all levels of government. **In the FBIH, total revenues** are expected to increase more than in previous years. A rise in social contributions follows the macroeconomic assumptions on the labor market for 2022–2023, along with two additional assumptions: **an expected increase in the number of employees and a rise in wages**. The indirect taxes as a share of this type of revenue available for the FBIH are growing more slowly because these depend on the **higher level of debt repayment in 2023** (the growth rate of the available part is only 0.6%). **An increase in direct taxes** follows the forecasts of GDP growth in the mentioned period, along with an **expected improvement in the realized profits of legal entities**, and the positive macroeconomic assumptions related to the labor market as well as the assumed **positive trends of realizing other taxable incomes sources** (“tax collection of personal income”). Again, there are no references to measures 9, 12 or any other (e.g. measure 16). The expected positive results in these budget items should be at least in part connected with the activities carried out under these measures during 2021.

The same assumptions for the revenue side of the budget are considered in the RS: the recovery of economic activity in the observed period and gradual income growth. The reasons are described similarly to the FBIH (“This projection is in line with their current movement, as well as with the expected developments in gross wages and the number of insured persons in the observed period”). Recovery could be the result of implementing some of the SRs in 2021 but there is no reference to measure 12 or any other measure.

On the expenditure side, total expenditures are expected to increase in both entities. **In the FBIH, increases in social transfers, compensations of employees and subsidies** are projected. The explanations are very short and there are no references to any SRs.

On the other hand, a decrease of the capital budget is projected. **In the RS, the same items are projected to increase / decrease but without references to SRs.** The SRs are planned to continue (“in order to maintain macroeconomic and fiscal stabilization, employment and recovery, and to accelerate economic growth”) but that statement contradicts with the description of the reform measures. Namely, according to the introductory part (4.1), only two measures included medium-term activities in the RS (measures 14 and 17). As for the RS, it is noted that financing of the mid-term framework will be provided mainly from external sources (the share of external sources will be 94% in 2021, 52% in 2022 and 78% in 2023) and that it includes new borrowing and “maximizing access to concessions sources of financing (World Bank, European Investment Bank, European Bank for Reconstruction and Development (EBRD), International Fund for Agricultural Development, KfW, Council of Europe Development Bank, etc.)”. There is no similar explanation for the FBIH, although financing from external sources (new borrowing) is expected there too.

According to the results of the analysis, the fiscal strategy and framework include some of the SRs but they are clarified insufficiently and imprecisely (repeated or overlapping explanations; unclear distinction between temporary and permanent allocations related to the measures; measures or sectors, not both, etc.). The presented fiscal strategy is mainly focused on the recovery after Covid-19 (fiscal stabilization) but does not include medium-term reforms that make this recovery sustainable and improve economic resilience. The gradual recovery is based on the continuation of the procyclical restrictive fiscal policy in 2021 and 2022, but based on the expected results of implementing restrictive public spending policies, no effects of SRs are mentioned.

There is no financial space to support the implementation of investment projects (budget items for capital investments are reduced practically throughout the period). Continuous implementation of the public investment policy is emphasized as a lever of medium-term growth in the BIH but the investment program is not presented at all. As regards the sources of funds for the implementation of the investment program, the description “using the available funds of international financial institutions” is not enough.

The fiscal strategy includes the public debt perspective, its fiscal impact and risks but at the same time the funds from these sources are not included in the financial framework. In light of that, it should be considered that the implementation of the investment program largely depends on the availability of these sources (“56.1% of the loans are directed to the implementation of infrastructure projects, 30.3% to loans to the public sector, and 13.6% to economic activities”). Similarly, the FF does not recognize donations (e.g. IPA funds) even at least indicatively in the narrative part. While BIH institutions generally do not

manage these funds (loans, donations), they should be included in the relevant chapters along with full amounts (FF – source of funds, SRs – appropriate measures), and institutions should make further efforts to meet the conditions for the disbursement of these funds.

Furthermore, the domestic sources of funds are not specified clearly enough. The information on resources that are expected to be generated from outside the central budgets is incomplete or unclear, e.g. in relation to local self-governments, extra-budgetary funds, directorates of roads or other institutions who manage public funds as set out by specific laws (all these sources belong to the category of non-tax revenues with specific purposes, such as the protection and development of the environment, water, forests, land, natural resources, public infrastructure, or with the purpose to support the unemployed, health protection services, etc.). All of these need to be connected to the program per their financial capacity (in the financial framework), and the roles of institutions that implement the measures (as leaders of activities or associates) should be defined too.

4. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

Most of the SRs have not been integrated into the FF; i.e. costs are not well defined or the total costs of measures are missing. Many measures lack the sources of funding. This is due to the lack of information on significant sources of funding (external and domestic) in the financial framework.

Information related to the assessment of the **costs of reform measures is mostly missing**. The reason may be the unclear definition of activities: e.g. for activities such as “drafting a strategy or drafting the laws” where it is noted that “these activities do not involve any additional costs because they are carried out by institutions as part of “regular” work”. But these measures do not include cost estimates for the activities carried out by other institutions involved. Even if the activities are carried out as part of institutions’ regular work, it is necessary to mark the budget line or simply point out that funds will be provided from the budgets of those institutions. Besides, cost estimates should be made for all activities, regardless of which institution carries them out.

The same goes for information on the sources of funds – they are not presented at all or only just partly defined. For example:

1. *Measure 3: Development and improvement of transport infrastructure.* The sources of funds are defined in the FBIH budget by budget items: subsidies, transfers and capital expenditures. It is not clear whether all external sources of funds are included, such as loans or domestic sources managed by other institutions (directorates of roads) or lower level governments (cities / municipalities or cantons in the FBIH). These resources are not part of the FBIH budget.

2. The sources of funds are partially identified in some measures, e.g. *measure 11: Health system reform*. It is noted that the sources of funds are the budgets of the RS and local governments but it is not clear which budget they belong to or which institutions manage the sources. Appropriate budget lines, such as capital expenditures, subsidies and transfers, have been defined but the sources of funds should be explained.

There are some **good examples of the connection with challenges / obstacles** (i.e. whether the measures are clearly defined and related to key or sectoral challenges / obstacles to growth):

1. Measure 2: Energy and gas market development. The measure addresses two identified obstacles: harmonization with EU standards and independence of gas supply. The measure includes the development and functioning of the internal energy market, the unbundling of transmission system operators and entity distribution system operators, and the establishment of organized markets. The connection of this measure with the BIH's obligations prescribed in the Stability and Association Agreement and the Treaty of the South East Europe Energy Community has been noted too.

2. Measure 5: Support to the manufacturing industry. Prominent negative effects of the pandemic on this sector is the first defined obstacle and in addition, the measure addresses several obstacles related to low product competitiveness, low level of technological development and development capacity. This is a good example how to show the transition from short-term (crisis recovery) to medium-term (support to investment projects) and long-term (development of the domestic production base) support. It is important to note that the activities related to anti-crisis support (temporary support) are clearly separated from the current ones within this measure.

Similar activities related to anti-crisis support are recognized in measure 8 too. However, in the context of the current ERP 2021–2023, which includes a specific measure for pandemic remediation assistance (measure 9), a coordinated approach is missing: all pandemic remediation activities should be allocated to an appropriate measure or treated separately in each area / measure (a recommendation in the EC Guidelines). It is necessary to decide which approach to apply in the ERP.

In addition, the analysis shows that **most of the activities are not complete**: either they are not defined for all years in the presented period or it is not clear which institution implements which activity. For example:

1. Measure 1: Energy and gas market development. The timeline of implementation is unclear in the mid-term period. It also remains vague, for example, whether the legislation in the field of energy at the state and entity levels is related to the activity entitled “Establishing of an organized electricity market”. From the description of the measure, it seems to be.

2. Measure 2: Improving energy efficiency and the use of renewable energy sources. The activities are listed as required laws and strategic documents with the institutions responsible for implementation in 2021, including legislation and strategic frameworks at the state and entity levels. For 2022, the activities include adoption of bylaws in the Federation and implementation of measures and policies defined in the Integrated Energy and Climate Plan, as activities at the state level. There are no activities identified for the RS. Activities for 2023 include only reporting to the Energy Community Secretariat, without the institution in charge (the Ministry of Foreign Trade and Economic Relations is in charge of reporting to the Secretariat but entity line ministries probably play a role in this process too).

Some of the measures should not be treated as measures, as they are in fact only activities or related to the obstacles identified in other measures. According to the description of measure 7: Establishment of economic instruments in the field of environment and energy efficiency, it seems that this measure should have been harmonized with measure 6 and treated as an activity under this measure. It only includes establishment of control over the implementation of funds managed by the Federal Environmental Protection Fund and an appropriate Information Technology (IT) system for reporting. These activities relate to the obstacle in measure 6 and refer to the lack of coordination between institutions in this area.

In some cases, obstacles have not been identified at all. For example, in case of measure 18 relating to the social protection system.

In general, there is a need to improve the content of the ERP in a formal sense, with a uniform presentation of measures, activities, their costs and sources of funding. It seems that institutions write the content individually without a coordinated / unified approach to the drafting of this document.

SRs should address the main identified challenges (a recommendation of the EC). In some areas, it is necessary to conduct analyses to identify the challenges and prioritize the activities based on the results of these analyses. The SRs should be clearly defined along with specific activities planned in the following three years. The costs of the measures should be estimated and sources of financing determined (Tables 10a, 10b).



CASE OF KOSOVO*

PREPARED BY EXPERT VALMIRA REXHËBEQAJ

1. EXECUTIVE SUMMARY

Key challenges: 2021–2023 ERP of Kosovo* coherently presents the key challenges and obstacles to growth. The challenges are specific and relevant, and they are generally well linked to the presentation of SRs. The majority of the SRs refer back or try to address the challenges identified in the key challenges section, which makes the whole document more coherent. Similarly, there is a reasonable amount of key challenges identified in the ERP, which allows for the design of specific measures to address them.

Fiscal Framework and Inclusion of Structural Reforms: In terms of the inclusion of SRs in the FF section, the ERP 2021–2023 seems to have a weak linkage between the two sections. Generally, despite some small references to the reduction of the informal economy in the overall fiscal strategy and the four measures assessed for their economic impact, the ERP FF contains no more references to SRs. None of the reforms are addressed in the FF section and the two seem not linked at all. As such, even though the reforms may be costed and included in the budget, the FF section fails to address

them or refer to their overall positive impact or the fiscal space needed to cover them.

Structural Reforms and Fiscal Framework: Overall, the presentation of the ERP measures is concise and coherent. The majority of the measures are well defined with a clear linkage to the key challenge they address, along with specific activities that are costed and have a budget funding line. In the annex, it can be seen that no measure is completely lacking the linkage with the key challenges or completely lacking budget funds. As a result, the overall presentation of SRs in the ERP is appropriate with some space for improvement in terms of strengthening the linkage with the key challenges of some reforms and better costing of their activities.

The main recommendation for improving integration into the next ERP is related to the FF referring back to the SRs and analyzing the impact of their implementation and the fiscal space needed for that. This would help in having a more coherent ERP document, which has clearly linked sections that reflect overall coherence.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

The key challenges are well defined and relevant. Several other analyses of the economy in Kosovo* have identified that the three most prominent challenges are related to education quality and mismatches with the labor market, the high level of informal economy, and energy savings and efficiency, among others.

The first challenges identified in the 2021–2023 ERP are related to the business environment. Despite improvements over the years, the ERP document concludes that challenges remain especially when it comes to informality and contract enforcement. The informal economy, even though it is estimated to have declined over the years, continues to account for a large share of GDP and presents an important obstacle. The obstacle of informality is well defined and clear, since it does have an impact on the overall economy, starting

from limiting the fiscal space of the government to spend in priority areas, to negatively impacting competitiveness and the export potential of Kosovar businesses. Weak contract enforcement and rule of law remain significant constraints, considering the backlog of unresolved cases. These factors have been noted as a key challenge in the Competitiveness Outlook too.

Likewise, insufficient and unreliable electricity supply is still a binding constraint. Some measures are thought to have slightly improved the situation; however, businesses continue to state that reliability, the cost of electricity and the tariff system are still problematic for them. Furthermore, the unreliable supply of energy is seen as one of the main constraints on competitiveness and productivity in Kosovo*. Similarly, the undiversified sources of energy remain a challenge despite the efforts to diversify them.

Environmental services have been identified as an emerging constraint due to the high levels of environmental contamination from mining, gas vehicles, waste removal and contaminated rivers.

Skills gap between education/training and labor market needs continues to be a growth constraint. Many Kosovar businesses identified problems in recruiting skilled workers for their sector and workers lacking language and computer skills. Likewise, the rates of return on education in Kosovo* suggest that the quality of education is low for several reasons. The issue related to the education system is analyzed from both sides: the quality of the actual education system and the problems transferred to the labor market. Reforms in the education system that will provide people with the relevant skills and competences needed in the labor

market is a necessity. On that note, the ERP includes four SR measures that aim to tackle this issue.

Overall, the ERP contains specific key challenges that summarize the main obstacles to growth. These challenges are grouped into three main categories, which makes it easier to understand them and the SRs linked to them. These three categories have also been identified by the EC and are present in other government documents, suggesting that there is agreement on them. Furthermore, the presentation of reforms is generally linked to the key challenges and address them in the SR section. Moreover, there is a reasonable amount of key challenges identified in the ERP, which makes the whole document more coherent. The challenges are focused on specific sectors and are consistent with the measures in the SR section.

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

The FF's goals are to ensure economic recovery after the pandemics and strengthening of the fiscal position. The two factors are identified as important for the successful implementation of ERP reforms. In addition, the Kosovo* expects to go back to the initial set of fiscal rules, after a temporary breach took place during the pandemics, to allow for additional fiscal space related to Covid-19 measures.

A great emphasis is placed on tax policies and tax administration to ensure that changes are made after consulting the business community, so that the new policies are in favor of economic growth and employment. As a result, the main objective in the FF is to increase voluntary tax compliance and reduce informality. This is expected to be done through automatizing many tax systems, encouraging businesses to operate in the formal sector by simplifying tax declaration procedures and increasing the benefits of operating in the formal sector, reviewing taxation legislation, and so on.

The framework also identifies three specific sectors – construction, hospitality and services – that are more prone to informality, and specific measures to monitor and assess their tax reporting.

In terms of budget plans, the revenues are foreseen to grow and stabilize after the pandemics as a result of economic recovery measures. On the expenditure side, some fiscal consolidation is expected to take place, as expenditures are projected to slightly decrease from their level in 2020. This is mainly due to the

multiple fiscal measures taken in 2020 to tackle the pandemics. However, some measures are expected to be implemented in 2021 too as part of the Economic Recovery program. In the medium term, expenditures are expected to stabilize and the average growth in 2022 and 2023 is foreseen to be only 0.4%.

The section also encompasses four SRs, along with their economic impact assessment, and discusses their fiscal costs. These reforms are Measure 1: Reducing energy consumption through energy efficiency measures; Measure 9: Establishment and functioning of the Commercial Court; Measure 11: Reducing the informal economy; and Measure 20: Increased employment due to targeted training of the unemployed. The same four measures are also discussed in the alternative scenarios section where their economic impact is assessed and explained.

For Measure 11: Reducing the informal economy, the third section, where the economic impact is analyzed, foresees an increase in direct tax revenues resulting from the implementation of the measure. An increase in direct tax revenues is assumed as a result of increased inspection efforts and other activities planned under SR measure 11, which are assumed to have an impact on increased tax bases and overall tax rates.

For Measure 1: Reducing energy consumption through energy efficiency measures, the scenario focuses on the energy sector in Kosovo*. The analysis foresees effective tariff adjustment and the resulting impact on the real, fiscal

and energy sectors. The implementation of the measure is supposed to affect positively government savings and increase investment, while the tariffs are supposed to lead to efficiency gains as consumption decreases.

For Measure 9: Establishment and functioning of the Commercial Court, the scenarios foresee a reduction in capital risk premiums, which will then lead to an increase in foreign financing.

For Measure 20: Increased employment due to targeted training of the unemployed, the scenario expects an increase in employment in specific household deciles.

In addition, the ERP contains a section that analyses the quality of public finances and public debt sustainability. It is explained there that Kosovo* continues to have relatively low levels of public debt to GDP, especially compared to

the region. Even in different alternative scenarios, public debt levels are expected to remain within certain limits in a ten-year period. Nonetheless, it is worth noting that the analysis is based on the assumption that fiscal rules will not be breached during the period, which seems to be a significant stabilizer of the debt levels.

All in all, despite some references to the reduction of the informal economy in the overall fiscal strategy and the four measures assessed for their economic impact, Section 3 of the ERP contains no more references to SRs. There seems to be no clear linkage between Section 3 and Section 4 that contains SRs. The other SRs besides the reduction of the informal sector are not mentioned as important in the fiscal strategy. At the same time, they are not assessed as having a large fiscal impact or risk due to their cost. The section also fails to explain how the fiscal space needed for funding the reforms was or will be created.

4. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

4.1. LINKAGE WITH THE FISCAL FRAMEWORK

This section analyzes the full costing and secured budget funding of the measures.

Based on Section 4 about SR measures, the annex to the SRs integration is completed. The findings suggest that most of the measures are fully costed and have a specific budget line. Likewise, it is worth noting that once a SR is costed and it is stated in the ERP that it is funded by budget funding, that measure is automatically part of a specific budget line. It is a practice of the Ministry of Finance, Labor and Transfers to draft its annual budget based on budget organizations and specific budget lines. Thus, even though the actual budget line is not specified in the ERP measure description, this does not mean that the measure does not have secure budget funding. Therefore, it can be concluded that once a measure is assessed as being fully costed, it will also have automatically a secured budget line.

The first two ERP measures related to the energy sector are assessed as being fully costed, given that the foreseen cost seems appropriate to cover the activities of the reforms. The measure on increasing the diversity of energy sources contains also some private funding, which is why the budget funding for that measure is left blank in the annex.

The measures on increasing competitiveness in agriculture, production and tourism are also assessed as being fully costed, since the foreseen activities seem to be

appropriately budgeted. Likewise, since they are funded mostly by the budget, they have secure budget lines.

The measure on reducing the administrative burden and implementing the inspections reform is also fully costed to cover the expected activities and has secured budget funding. In addition, the two reforms related to RDI are assessed to be fully costed.

Measure 8 on the Commercial Court is assessed as being fully costed with secure budget funding. The costs for this measure are calculated under the Justice Council.

Measures 15, 17 and 18 related to education are also assessed as being fully costed with secure budget funding.

On the other hand, eight of the measures in the 2021–2023 ERP are only partially costed or have no secure budget lines. Measure 6: Increase competitiveness in the sector of trade in services seems to be not fully costed, as the foreseen cost seems insufficient for the planned activities.

The two measures related to the level of informality – in the real estate sector and the overall informality – are assessed as not being fully costed. In the former case, the cost has remained the same as in the previous year and so there is uncertainty whether new activities have been costed. In the latter case, the cost appears to be insufficient to address the activities presented. The total budget of EUR 570,000 appears insufficient to cover the anti-

pated additional staff as well as the creation and implementation of two new IT systems, one aimed at reducing compliance risks and the other at identifying taxpayers.

The measure on trade facilitation through reducing the cost of trading transactions is also assessed as not being fully costed. This is because it is not a feasible cost considering the activities planned. These include a feasibility study and an information exchange platform, which can be costly and so the budget may be insufficient.

Measure 14: Further development of quality infrastructure and empowerment of the role of market surveillance authorities, with a focus on construction products, also has unrealistic costs, since accreditation specifically may be costlier than planned.

Measure 16: Implementation of the new curricular framework in VET system is also assessed as not being fully costed, since the link between the goals and the cost seems unclear.

Lastly, measure 19: Improvement of social and health services and empowerment of marginalized groups is assessed as not having clear secured budget funding. Even though the measure specifies where the bulk of the funding comes from (budget of Kosovo* and IPA funds), it is unclear whether the whole cost has been budgeted under the respective institutions. In addition, since the laws are yet to be adopted, it is unclear if the adopted budget includes such a cost.

4.2. LINKAGE WITH CHALLENGES / OBSTACLES

Thirteen out of nineteen measures are assessed as clearly defined and clearly linked with the key challenges. These include the measures linked with the energy sector issues, education sector mismatches, research and development, and economic integration.

On the other hand, the following six measures, which fall mainly under the informal sector, agriculture and services, and business environment, are in some cases unclear or contain unclear activities.

The measure on structural challenges in the agricultural sector does not clearly address the key structural challenge. That is because the measure proposal fails to address several significant structural barriers to the agricultural sector's development (e.g. small average farm size, low productivity, high production costs).

The measure on increasing competitiveness in the hospitality sector does not clearly address the key structural challenges, as the main purpose of the measure is to promote development of competitiveness in the tourism sector. However, the measure fails to tackle illegal landfills and cleaning waste across the territory, which is a precondition for attracting tourists. Furthermore, some of the activities are not clear and not well targeted.

Measure 7 on the improvement of the business environment by reducing the administrative burden and implementing the inspections reform also lacks clear activities. The main activity is related to digitalization – the development and implementation of the electronic platform E-inspection – and there is no consistent activity regarding the necessary procedures to reduce the administrative burden of citizens, businesses and the administration. Furthermore, no concrete activities are provided for the digitalization.

The measure on the establishment of the Commercial Court lists clear activities; however, the reform itself is not as complete, lacking information about the amount of staff required. Furthermore, the proposed measure lacks information on the Court's premises as well as the activities appropriate for its functionalization.

Measure 9 on the reduction of informality in the real estate sector has well specified and clear activities but the measure is not sufficiently developed to tackle informality, as it does not address uncontested informal transactions. At the same time, measure 10 on reducing the overall informality level contains some activities that are not really as well-defined or targeted as others. They lack a measurable component, which could make implementation difficult, such as better coordination or increased number of inspections (without specifying a precise target).

Overall, the description and presentation of measures in the 2021–2023 ERP has improved greatly. Despite some cases when the measures are partly clear or partly costed, the majority of them are well specified and appropriately costed. The ERP does not include any that are not linked with the key challenges or not costed at all. Therefore, based on the scoreboard, the presentation of SRs in the ERP is appropriate, with some room for improvement.



CASE OF MONTENEGRO

PREPARED BY EXPERT TIJANA STANKOVIĆ

1. EXECUTIVE SUMMARY

The analysis of SRs integration into the FF in the seventh Montenegrin ERP 2021–2023 shows significant improvements on one hand and chronic issues on the other hand.

The ERP 2021–2023 is transitional, bearing in mind the fact that Montenegro got a new government in December 2020 after the parliamentary elections in summer. The pillars of economic and social development (green economy, digital transformation, regional connectivity and cooperation, improvement of competitiveness, social protection, society of same opportunities and good governance) listed in the “Overall Policy Framework and Objectives” are in line with new EC Guidance for ERP 2021–2023 and mostly consistent with the proposed SRs.

Analysis of the obstacles to sustainable and inclusive economic growth and competitiveness is not comprehensive and consistent enough to map the authentic and real challenges of the Montenegrin economy and society. One reason could be insufficient coordination – policymakers

should be active stakeholders in the process of ERP drafting. The other reason could be the disorder of steps during document drafting, meaning that the analysis of obstacles and consequentially identified challenges must precede the design and prioritization of the reform measures. The reform measure is an answer to the challenge, not vice versa. Capacities exist and should be coordinated and used. For example, the ERP 2021–2023 mentions some chronic obstacles in other chapters but fails to do so in the analytical part of SRs.

The chapter on SRs provides methodologically correct and reliable costing for most of the SR measures. The fiscal policy goals and mid-term FF do not directly integrate the fiscal impact of SRs. Their economic impact is taken into account in projecting GDP growth, which serves as the basis for fiscal policy goals.

Each SR measure needs to be an integral part of a holistic approach to the whole chapter analysis in order to achieve consistency in Chapter 5 and between Chapters 3, 4 and 5.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

The Montenegrin ERP lists three key challenges of long-term, inclusive and sustainable economic growth and development: increase in labor market activity, strengthening of regulatory framework and formalization of the economy, as identified in subchapter 5.1. All three challenges are in line with the EC's assessment of the ERP 2021–2023. Recommendations from Joint Conclusions for the Montenegrin ERP 2021–2023 are quoted too. Besides three structural challenges, there are those brought to the surface by the Covid-19 crisis. Some of them are in line with the key challenges.

More obstacles are analyzed and challenges listed in subchapter 5.3 “Analysis of main obstacles”. Some of them are in line with the key challenges, while others highlight more specific obstacles in certain reform areas.

In some cases, the reader has to assume what the obstacle could be and link it somehow with a SR measure because these are not clearly specified in the text.

The Montenegrin ERP fulfilled the form regarding the identification of key challenges; however, there is no deeper analysis how these challenges were selected. The EC assessment is taken into account very precisely, but it should be the direction, not the basis for the identification of key challenges. Challenges should be conclusions of an analysis of the obstacles. The Montenegrin ERP misses the analysis and identification of the main obstacles to growth. Interestingly, the reader can find some important and structural obstacles in other chapters of the ERP (e.g. FF), like negative demographic changes that affect the aggregate demand and the labor market, education and

health systems, pension schemes and public finances, as well as the unfavorable structure of the Montenegrin economy that makes it very vulnerable to external shocks. These obstacles represent a sound basis for defining the challenges but they are not used in the analytical part of the reform areas.

The analysis of obstacles in the reform areas is not consistent in form and substance in case of several measures. Some obstacles and challenges are clearly identified and precisely analyzed, while others lack clarity. In some cases, there is plenty of statistical data without any analysis or conclusions. One can conclude that the identified obstacles address the measures, not vice versa as it should be, leaving the impression that measures have been designed before identifying the obstacles. For example, the reform area “Education and skills” lists only obstacles to which the provided measures could be an answer. The only obstacles in the field of labor market are those resulting from the pandemic, and the measures foresee legislative adjustments to extraordinary situations like the pandemic.

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

Due to the change of the governing structure in Montenegro at the end of 2020, the adoption of the Law on Budget for 2021 in the Parliament followed only in July 2021. Until then, the model of temporary financing was valid, according to which each budget unit received every month one-twelfth of its expenses incurred in the previous year.

Public finances in the Montenegrin ERP for the period 2021–2023 are presented through (1) the impact of the Covid-19 pandemic on the increase in the public finance deficit and public debt, (2) the reduction of public spending in the mid-term due to the completion of the highway section, and (3) the ambitious fiscal goals in the medium term. The estimated costs of the 20 priority reform measures as well as the challenges they address have not been analyzed as part of the FF 2021–2023.

The budget deficit reached a high level in 2020 at 11.1% of GDP, and the public debt was the highest ever at 104.2% of GDP. The interruption and restriction of certain economic activities, the interruption of international traffic and the decline in tourism turnover, which determines the trends of the Montenegrin economy, produced a 20% decline in public revenues compared to the original plan.

The Montenegrin ERP 2021–2023 should recognize real long-term problems and concrete obstacles to the development of the overall economy and specific reform areas. The obstacles in the reform areas could be in line with the key challenges, but not necessarily. Identifying bottlenecks can contribute to better identification of challenges that will be addressed with reform measures designed by line ministries.

Thus, it is very important to follow the proper order of steps: first identify the obstacles, then define the challenges, and at the end design and prioritize the measures based on previous analyses. The statistical data in Chapter 5 should support the analysis of challenges, so that the country could design and prioritize reforms that it can implement effectively. The ERP should not be a mere checklist but make use of the EC assessment and joint conclusions to identify the real challenges and improve the process of designing well addressed and prioritized reforms that would reduce or eliminate the obstacles to sustainable and inclusive growth and competitiveness.

Due to the large deficit of public finances and the 15.3% economic decline, the government of Montenegro has set the necessary and ambitious fiscal policy goals in the short and medium term:

- Gradual reduction of deficits in 2021 and 2022
- Reaching the surplus in 2023
- Reduction of public debt to 69.9% of GDP by 2023

The basis for the recovery of public finances lies in a number of factors, such as projected economic growth of 10.6% in 2021, 6.5% in 2022 and 5.8% in 2023, reduction of the informal economy, taxation of undeclared property, marking of mineral oils and their derivatives, abolition of the highest base for payment of contributions, increase in a number of excises, and payment of dividends by state-owned companies.

Although the SRs chapter follows the given structure, identifies key challenges and budgets the costs of each measure individually, the FF chapter does not clearly and adequately present the impact of SRs on public finances. Neither is this impact obvious from the analysis of the realization of public revenue and spending flows in 2020, or from medium-term projections.

Chapter 5.1 identifies structural challenges: (1) increasing labor market activity, (2) strengthening the regulatory environment, and (3) formalizing the economy. Chapter 4 “Fiscal Framework” mentions some obstacles that are not the direct basis for these explicitly stated challenges. For example, weak diversification of the economy, negative demographic trends and inadequately structured tax policy (high tax burden on labor and low on capital).

The subchapters “Budget Plans for 2021” and “Medium-Term Budgetary Outlook” analyze the effect of the planned measures that have a direct impact on public revenues and do not fall within the scope of SRs (increase in excise duties, labeling of mineral oils and their derivatives, reduction of the VAT rate on certain products, conditions for payment of contributions, new sources of income). The analyses of public spending in 2021 and in the mid-term state the continuation of providing support in the pandemic situation as a priority, as well as fiscal adjustment through the reduction of all categories of discretionary spending. Although Tables 10b contain clear sources of financing the reform measures in 2021 (without being able to be presented as sources “to be determined”), the amount of these expenditures, both from the central budget and from loans and grants, has not been analyzed in the FF.

The basis for the projection of the decline in public spending as a share of GDP in the medium term are the measures aimed to reduce discretionary spending (completion of the highway section) and the growth of mandatory expenditures in the situation of projected high GDP growth rates. There is no mentioning of SR measures either as a possible impact on public spending or as an impact on competitiveness and public revenue growth.

Analyzing the structural balance, the reduction of the output gap in 2023 is stated as a result of economic growth above its potential. However, the sources of such growth as well as the rise in budget revenues do not origin from the SRs.

The public debt analysis provides the sources of financing and lists the above-mentioned development projects for the improvement of agriculture, energy efficiency and tax administration, construction of water treatment plants and water supply systems, construction and reconstruction of roads, development of agricultural clusters, procurement of helicopters and armored vehicles, etc.

Thus, some of the development projects are listed, whereas others are not of a developmental nature. Some of development projects can be related to SR measures but there is no explicit mentioning of that. None of the mentioned sources of financing in the subchapter addressing public debt are presented as a source of financing of reform measures in Table 10b, nor are they part of the SRs. The amount of the item “Project loans” in Table 10b is equal to zero for each reform measure, although some project loans are mentioned throughout the text. Furthermore, new activities for the implementation of projects in the period of 2021–2023 are not planned, except for the continuation of infrastructure projects. In summary, there is no direct link between the analysis of public debt and the impact of SR measures on the debt.

As the fiscal goals are based primarily on economic growth, it was necessary to look at the factors underlying the growth projection of Montenegro in 2021–2023 in the subchapter “Medium-term macroeconomic scenario”. This subchapter provides a much clearer yet an indirect link between the FF and SRs. Namely, the “establishment of a downward trend of public finance deficit and debt contributes to macroeconomic stabilization”, which is achieved by “implementing targeted SR measures, dynamizing economic growth and further optimizing public administration”.

On the other hand, the projected economic growth is, among other factors, driven by the announced investment projects in energy, agriculture, industrial production, tourism, transport and telecommunications, and the IT sector. The assumption is that these are state investments because all these areas belong to the areas of SRs and related measures. Economic recovery is based on the new postulates of innovation, digitalization and green development. Basing growth on new postulates aims to increase the resilience and sustainability of the Montenegrin economy. Inclusive economic growth and sustainable development could be achieved through RDI and digital transformation, which is an integral part of the reform measures in Chapter 5.

To reduce external exposure of Montenegro, the focus of economic policy in the macroeconomic framework is on diversifying the economy and sustainable development. Although not mentioned as a key challenge in Chapter 5, the unfavorable structure of the Montenegrin economy is observed through the FF chapter. Therefore, economic growth is focused on the growth of agricultural

production, energy and processing industry to strengthen competitiveness and reduce the import dependence of the Montenegrin economy.

It is interesting that all Covid-19 measures have very precise budgeting and have been integrated into the FF chapter. The Covid-19 pandemic increased public spending due to additional financing of the health system and financing of three packages of socio-economic measures for combating the negative effects of the pandemic for the citizens and the economy. The first two packages were spent during 2020, and the third

refers to a four-year period. At the beginning of 2021, the fourth package of socio-economic support measures was adopted. The analysis of the expansionary fiscal policy and costing of measures aimed to combat the negative effects of the pandemic in 2020 are clearly presented. These measures are divided into several groups: tax policy measures, direct support measures to the economy, measures aimed at preserving the liquidity of the economy, support measures to the health system, other measures and long-term measures. Each measure is financed from the central budget with full and clear costing.

4. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

The SRs chapter is well structured and contains all elements prescribed by the EC Guidelines 2021–2023. The majority of reform measures are costed according to the CEF Methodology for costing SRs³. The critical approach to scoring comes from the fact that all the “rules” were very well known right from the beginning, the majority of authors have experience in drafting Chapter 5, and costing and additional training was provided.

Three main challenges are addressed to facilitate private investments and their impact on sustainable and inclusive growth and competitiveness, thus increasing public revenues. They are correctly set but, as emphasized in Chapter 2 in this case study, not based on an analysis of identified obstacles. Most of the obstacles in the reform areas are too narrowly defined to be addressed by the proposed measures. Thus, most of the reform measures have a clear and direct connection to the obstacle identified, and only some of them address the key challenges. There are very few of those that do not address any challenge or obstacle. For example, it is not clear which obstacle the reform of the study model 3+2+3 addresses (“Reforms of the study programs of bachelor and master studies with special focus on practical teaching”, measure 15). Especially because the new study model was introduced in 2017 and it has created new non-adjustments of the labor market. However, the labor market reforms do not respond to those non-adjustments.

Most of the reforms are defined and described according to the challenges identified in the analysis. There are some titles that are too general and do not reflect

the aim or main activity of the reform. For example, “Improvement and implementation of the measures for the reduction of informal economy” imposes the drafting and implementation of an action plan for the reduction of the informal economy and for research that precedes that plan. Therefore, the name of the reform could be more specific and closer to the substance of the measure.

The majority of measure descriptions follow the prescribed structure. Those described shortly usually contain all the necessary information, like the “Implementation of the electronic system of public procurement”. Those with too long descriptions, on the contrary, usually contain achievements from past years, parts that belong to “activities” or some statistics without any explanation. For example, the reform measure “Improvement of legal and regulatory framework as well as further development of infrastructure for broadband internet approach” contains text that distracts the reader from the purpose of the reform. Usually, too long descriptions lead to weak and unclear explanations of the activities.

SR measures are generally well budgeted. Every measure is costed and includes clear information about the sources of financing. There are some measures where activities imply a new cost that is not included in Table 10b. For example, the “Reform of national system for determination of disability” (measure 19) includes an analysis that provides the exact costs of some actions. Some measures refer to “expectations” on funding for some costs. Any reform that relies on an expectation regarding the evaluation of costs or funding, should not be part of the ERP. There is also a problem of inconsistency

between the textual description of the costs and the figures in Table 10a. Tables 10a and 10b are consistent with each other but the figures in the text are inconsistent with the tables. So, which one is correct?

There are measures that include non-additional costs in costing. It confirms a need for continuous and regular training in costing methodology due to fact that people in line ministries are changing and are not familiar with it.

Definition of an activity tells a lot about its costing. If the activity is concretely and precisely defined and shortly described, then costing can be more precise and easier to calculate. If the activity is too general, then figures are usually rounded and financing is typically inconsistent or “expected” to be found.

The Montenegrin ERP implements a “measure to measure” approach; a holistic approach is missing. The FF chapter does not analyze the costing of SRs and their mid-term impact on public finances. It focuses on the revenue side through the impact of SRs because the mid-term fiscal policy goals (surplus of public finances and significant decrease of public debt) are set according to economic growth. The basic scenario of economic growth incorporates the qualitative impact of SRs. Although some SRs have impact on revenues nature (e.g. measures related to reduction of the informal economy) should lead to increased revenues, revenues are not evaluated.

The SRs chapter serves as a solid basis to be qualitatively incorporated into the FF and economic growth projections. Every author has made an effort in costing the reforms and identifying the obstacles in their field of work. But to achieve better consistency and quality of the entire policy document, it needs coordination on higher levels of government and also in the MoF. High-level officials, coordinators and sub-coordinators should communicate more frequently during the process of ERP drafting.

One can also conclude that some measures have not been selected with the aim to initiate or accelerate growth and development but to cover all reform areas and meet the requirements of the EC. In some cases, when a ministry has a measure on the table, then the challenge in that reform area is defined according to “what the ministry has”. In a word, the holistic approach is missing, from the identification of obstacles to clearly incorporating the costs of SRs into the FF.

Consistency should be mentioned as an issue too. Although the consistency of the Montenegrin ERP 2021–2023 has significantly improved compared to the first document with the EC on economic and fiscal governance, there is room for further improvement. Namely between the obstacles to growth and competitiveness on one side and the measures on the other side, as well as between the description of costs per activities and Tables 10a and 10b, and SR implications on the economy and public finances.



³ https://www.cef-see.org/assets/files/Costing_Guidance_2.pdf



CASE OF NORTH MACEDONIA

PREPARED BY EXPERT SILVANA MOJSOVSKA

1. EXECUTIVE SUMMARY

The key challenges identified in the ERP 2021–2023 of North Macedonia correspond to the ones noted by the EC: (1) improving the quality and relevance of the education system; (2) improving the competitiveness of domestic companies and integration in global value chains, and (3) formalization of the economy.

There are 20 structural measures in the ERP 2021–2023, elaborated in most of the areas defined in the EC Policy Guidance and aiming to address the key and sectoral challenges. The FF for the ERP 2021–2023 has been responsive to the Covid-19 crisis, with mid-term plans for fiscal consolidation projected on increased revenues and decreased expenditures. North Macedonia has adopted a Tax System Reform Strategy and introduced rules on spending related to capital investment, aiming to ensure more stable budget execution. The SRs have been well incorporated into the FF, as the procedure for

incorporation of a measure in ERP of North Macedonia is conditioned with ensured finances.

The assessment of the structural measures with regard to their compliance to the key or sectoral challenges / obstacles, and coherence of reform objectives and activities, as well their integration into the FF of the ERP 2021–2023 have indicated generally positive results. All structural measures receive positive assessment with regard to links to the key challenges, with key challenge 2 being addressed by 3/4 of the measures. On the other hand, the elaboration of the reforms and related activities in terms of clarity, consistency and incorporation of all necessary aspects varies a lot. This is an area for further improvement of the ERP. With regard to the integration of the SRs into the FF of the ERP 2021–2023, there is an overall positive assessment of the Programme.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

The key challenges identified in the ERP 2021–2023 are as follows: (1) improving the quality and relevance of the education system; (2) improving the competitiveness of domestic companies and integration into global value chains, and (3) formalization of the economy.

The key challenges have been mentioned in the introduction and Section 5.1 of the ERP 2021–2023. Both sections are aligned to each other. The introductory part does not explain the challenges but states that other national strategic documents have been taken into consideration in the process of ERP elaboration, along with the EU main strategic directions towards green growth and digital economy and society, and the United Nation SDGs. The key challenges in the ERP match the challenges identified by the EC in the Joint Dialogue between both parties in 2020.

The key challenges / obstacles are well defined and identify the major factors affecting / causing them, supported by findings of the comparative reports of international organizations in respective fields. The major (sub)areas or problems that should be addressed to overcome the challenges are identified in Section 5.1 of the ERP 2021–2023:

- Any further intensifying of the economic growth will undoubtedly be hampered by the pandemic's negative impact and the great uncertainty revolving around its length.
- The projected economic contraction along with the newly emerging indebtedness needs will ruin the stabilization period of debt stabilization as a result of the reduced budget deficits in the last years.
- Employment growth is not followed by commensurate economic growth and many new jobs do not feature high productivity that is inevitably needed.

- The substantial structural change in the manufacturing sector in the past couple of years (thanks to the increased share of production based on high technologies) is still insufficient to convert into higher value added per capita as a measure of the level of industrialization.
- The inconsistencies between the needs of private employers and the skills gained with the educational system pose a problem in reducing the high unemployment rate, especially the youth unemployment rate which was 47.6% in 2017, three times higher than the EU average.
- Greater integration of companies into the global chains of higher technological value largely depends on further improvements in the business environment. There is a need to improve the enforcement of the legislation, as well to simplify the current regulation and reduce unnecessary expenses.

- It is needed to keep up with its efforts to improve the competitiveness of the energy industry, and specific attention should be paid to sustainable growth, given the potential for sustainable energy and efficient energy use.
- The lack of measures aimed at tightening the informal sector may slow economic recovery from the pandemic crisis, and it may also hamper the sustainability of economic growth in the long run.
- Apart from the battle against the informal economy, other major challenges in developing an inclusive society include fight against corruption, respecting the rule of law, and increasing the level of transparency and the reliability of institutions.

In addition, there are specific challenges elaborated in the diagnostic for each area of SRs, which are generally well aligned with the challenges mentioned above.

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

The government of North Macedonia has defined the next mid-term fiscal policy based on three platforms: (1) Smart Growth 2021–2025 for the recovery and sustainable development of the economy, (2) Fiscal consolidation 2021–2025, and (3) Public Investment Plan 2021–2025. The key elements of the medium-term fiscal policy are redesigning the budget policy and fiscal consolidation. They are aimed at supporting macroeconomic stability and accelerating economic growth, thus strengthening the growth potential of the national economy.

Total revenues of the 2021 Budget are projected to be 8.3% higher in relation to the second 2020 Supplementary Budget, while expenditures are projected to be 2.1% lower. This is expected to result in a budget deficit of 4.9% of GDP.

On the revenue side, tax revenues are projected to grow by 8% in 2021 in relation to the second 2020 Supplementary Budget. VAT accounts for the largest share (44.3%) of the projected tax revenues and excise duties constitute 21.4%.

On the expenditure side, despite an overall decline in spending foreseen for 2021, there is a planned increase in the expenditures related to the North Atlantic Treaty Organization (NATO) membership and a rise in public administration wages and pensions, as well as subsidies and transfers for different purposes, including mitigation of the Covid-19 crisis.

Capital investments are also projected to rise by 26.2% compared to the second 2020 Supplementary Budget, whereby funds are planned from several sources: budget funds, IPA funds and loans. These funds are intended for the intensification of infrastructure projects, i.e. investments in road and railway infrastructure, energy and utilities infrastructure, as well as capital investments aimed at improving the conditions in the health, education and social systems, agriculture, culture, sports, environmental protection and judiciary.

The budget deficit of 2021 and debt repayment are projected to be financed by external borrowing and borrowing on the domestic government securities market.

The budget deficit is projected to gradually decrease from 4.9% of GDP in 2021 to 2% of GDP in 2025. The projected revenues of the general government budget in the next five-year period will decline from 32.6% of GDP in 2021 to 31.3% of GDP in 2025. Total expenditures of the consolidated budget are also foreseen to decline: from 37.6% in 2021 to 33.4% in 2025.

In the medium term, the main objective of the tax policy is to ensure sustainable economic growth and development, thereby providing for the legal safety of taxpayers and collection of tax revenues on a regular basis. This has been outlined in the Tax System Reform Strategy 2021–2025, with the key objective of ensuring

a fair, efficient, transparent and modern tax system based on modern digital technologies and innovations. The ultimate goal is to boost inclusive and sustainable economic growth. The implementation of the Strategy will be assessed on the basis of the Performance Assessment Framework, containing detailed instructions on the assessment of each measure.

The expenditure side of the 2021–2025 budget has been prepared with the view of achieving the strategic priorities and accelerating economic growth and the EU integration process. To improve capital expenditure execution, a new mechanism is introduced with the Law on 2021 Budget Execution: an obligation for the budget users to execute 15% of the capital expenditures in the first quarter, 40% as of the second quarter inclusive, and 65% as of the third quarter inclusive. In case of failure to do so, the MoF has an obligation to reallocate the unused funds.

The mid-term budget perspective on the expenditure side has been defined to ensure financial support to the following activities related to the SRs:

- Implementing active employment policies and measures, aimed at developing employment programs, measures and services that would improve the functioning of the labor market and support job creation, including youth employment (youth guarantee).
- Boosting economic growth and development by enhancing private sector competitiveness via measures for new investments, measures to support exports and conquer new markets, support to job creation and SMEs, innovation activity, technological development and research, as well as encouraging foreign and domestic investments.

Furthermore, the projections include that in the period of 2021–2025, the government will focus on the implementation of capital infrastructure projects in the road and rail infrastructure, energy and utilities infrastructure, as well as capital investments aimed at improving the conditions in the health, education and social systems, the agricultural sector and environmental protection. Substantial use of foreign assistance from IPA 2 has been planned for the realization of capital investments. More specifically, in the total amount of EUR 142.1 million: EUR 112.8 million from IPA funds, EUR 29.3 million as national co-financing from the state budget, and EUR 124 million as loans from international financial institutions.

Mid-term projections also state that significant projects will be implemented in the above-mentioned areas, to implement the reform measures aimed at improving social welfare and the education system, as well as managing the consequences of Covid-19.

With regard to the specific linkages of the mid-term planning to the structural measures, the following has been noted in the ERP 2021–2023:

- As regards the road infrastructure, loan funds are projected for the construction of Skopje-Blace highway section and Kicevo-Gostivar highway section; improvement of the road infrastructure in municipalities under the Local Roads Construction and Rehabilitation Project; financing of the Road Corridor VIII – Kumanovo-Rankovce section, Rankovce-Kriva Palanka section, Kriva Palanka-Bulgarian border, Kicevo-Ohrid highway section, Stip-Radovis road section, and Tetovo-Gostivar highway extension; the National Roads Program; the WB Trade and Transport Facilitation Project, and the Skopje Rapid Bus Transit Project (linked to measure 4, Chapter 5).
- For the railway infrastructure, the following is envisaged: financing the three phases of construction and rehabilitation of the eastern part of Rail Corridor VIII (the part towards the Republic of Bulgaria), EUR 130 million grant funds from the EU being provided for the second and the third phase, as well as commencing the Project for Construction of New Railway Section Kicevo-Border with the Republic of Albania as part of Corridor VIII. The construction of Tabanovce joint border station with accompanying facilities between the Republic of North Macedonia and the Republic of Serbia is planned to be financed with grant funds from the WB Investment Framework and an EBRD loan (linked to measures 15 and 16, Chapter 5).
- The following major projects are foreseen in agriculture: Irrigation Program North Macedonia and Agriculture Modernization Project. The construction of irrigation systems in Valandovo is envisaged too, to be financed with a KfW loan and grant funds, implementing the second phase of the Irrigation Program Southern Vardar Valley (linked to measure 5, Chapter 5).
- Capital projects in the health sector include the construction of the University Clinical Centre in Skopje and the reconstruction and extension of the Regional Clinical Hospital in Stip. Taking into account

the need to support the healthcare system for the purpose of managing and mitigating the impact of Covid-19, a World Bank loan is provided for financing the Emergency Covid-19 Response Project (linked to measure 20, Chapter 5).

- In the education sector, financing the reconstruction of student dormitories is envisaged, while the implementation of the Project for Construction of Physical Education Facilities in Secondary Schools and the Project for Construction of Physical Education Facilities in Primary Schools and Rehabilitation of Primary and Secondary Schools will continue, financed with the Council of Europe Development Bank (CEB) loan and national co-financing. This is to improve the physical education and overall conditions in primary and secondary schools. For the purpose of improving learning conditions in primary education, the Primary Education Improvement Project will be launched with a World Bank loan (linked to measure 18, Chapter 5).
- Related to the development of skills and innovations, the implementation of a project which, among other things, supports the activity of the Fund for Innovations and Technological Development will continue until April 2021 (linked to measure 13, Chapter 5).
- Two major capital projects are financed in the field of municipal infrastructure: the Municipal Services Improvement Project and the North Macedonian Public Sector Energy Efficiency Project. Under the Municipal Services Improvement Project, funded with a World Bank loan, municipalities and public utility enterprises are provided for financing investment projects in line with their priorities in the fields of water supply and wastewater drainage, management of solid waste and other investments in municipal services, which have potential for generating revenues, i.e. making savings, or are of high priority for the municipalities. The North Macedonia Public Sector Energy Efficiency Project will provide for financing energy efficient projects in the municipalities as well as public health institutions at the central government level (linked to measure 3, Chapter 5).
- The energy infrastructure projects envisaged to be financed are those implemented by AD ESM and AD MEPSO: Wind Park Bogdanci, phase 2, a district heating system for Bitola, a 400kV interconnection transmission line Macedonia (Bitola) - Albania (Elbasan),

Photovoltaic Power Plant Oslomej, Wind Park Miravci, Lindane Cleaning Project (OHIS), Photovoltaic Power Plant Oslomej 2 Project, and Photovoltaic Power Plant Bitola Project (linked to measures 2 and 3, Chapter 5).

- PFM reforms include improving the FF, strengthening the process of budget planning and execution, enhancing revenue collection, strengthening the public procurement system, internal and external control and transparent reporting. To this end, a project for setting up an integrated IT system for PFM and an integrated tax IT system is envisaged to be implemented (linked to measure 9, Chapter 5).

With regard to the structural budget balance, the projected GDP in 2020 has been substantially below the potential; hence, the cyclical budgetary component is negative, accounting for around 2%. The cyclically adjusted budget deficit accounts for 6.6% of the potential GDP, pointing to a fiscal impulse of around 4%. In 2021 and 2022, automatic stabilizers have a negative effect on the budget balance, whereby the estimated cyclically adjusted budget deficit is lower than the projected budget deficit for this period, at the same time narrowing to 3.5% in 2022. In the period of 2021–2025, the cyclically adjusted primary budget deficit accounts for 2.5% on average annually.

The FF for the ERP 2021–2023 has been responsive to the Covid-19 crisis. The fiscal consolidation plan looks a bit optimistic, as the increase in tax revenues must be fueled by strong economic growth, while the decline in expenditures relies on stable environment for budget execution, i.e. no unforeseen ad hoc spending. It must be noted that the rise in public administration wages and pensions reflects an increase in the threshold of regular expenditures. It is positive that the Tax System Reform Strategy was adopted and introduced rules on spending related to capital investment to ensure better budget execution.

The SRs have been well incorporated into the FF, as the procedure for incorporation of a measure in ERP of North Macedonia is conditioned with ensured finances. The mid-term fiscal outlook of the ERP 2021–2023 also mentions specific measures (as noted above), indicating stability of planning funding for the measures. On the other hand, it must be taken into consideration that budget execution in 2021 is still Covid-19 related, which could imply certain reallocation of finances.

4. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

The ERP 2021–2023 contains 20 structural measures, elaborated in compliance with the EC Policy Guidance adopted in 2020. The areas of SRs covered in the ERP 2021–2023 include energy and transport market (four measures); agriculture (four measures); business environment and reduction of the informal economy (four measures); RDI, and digital transformation (two measures); economic integration reforms (three measures); education and skills (one measure), and social protection and inclusion, including health care (two measures).

There are three areas of EC Guidance for North Macedonia, which have not been incorporated in the ERP, i.e. no SR measures have been elaborated. These are the industrial sector, the services sector, and the labor market. Key challenge 2 refers to increased competitiveness of the national economy and integration into the supply chains, implying that these three areas should be further considered to be included into the future ERP.

Key challenge 2 has been addressed with 15 measures (out of 20), indicating that 3/4 of the measures directly or indirectly contribute to increasing competitiveness, which is rather positive. However, the impact assessment of SR measures could be further improved to allow prioritization based on the economic, social and environmental impacts of the measures.

The measures within the areas of SRs are rather coherent and contribute to the sectoral objectives, although the links between them are not always stated and stressed. This particularly refers to the measures in the agricultural sector. Reference to linkages of the measures is provided in the area of economic integration.

The total cost of financing the SR measures in the ERP 2021–2023 is EUR 248,736,297 for the whole period. Of that amount, EUR 99,435,013 are provided from the central budget, EUR 8,830,000 are funds from other national public finance sources, EUR 46,352,000 from IPA funds, EUR 11,669,097 are provided through other grants and EUR 82,495,187 through project loans. Central budget funds account for 40.0% of total financing costs, 3.5% of total funds are provided from other national public finance sources, IPA funds account for 18.6% and other grants for 4.7%, while 33.2% of total funds are provided through project loans.

The detailed analysis of the measures with regard to their compliance to the key or sectoral challenges / obstacles, and coherence of reform objectives and activities as well their integration into the FF of the ERP 2021–2023 has been provided in Annex 1.

The outcomes of the analysis indicate the following:

- All twenty measures refer to certain key sectoral challenges or specific EC Policy Guidance Notes. The three key challenges as defined in the ERP have been addressed with the measures. In addition, specific sectoral challenges are addressed with some measures. National strategic documents, SDGs and relevant EU documents have been consulted to better elaborate the measures. In all measures, the core of the reforms as presented in the ERP confirms the linkages with the challenges, with variations with regard to the elaboration of the specific impacts of the measures in overcoming the key / sectoral challenges.
- Clear, concise and specific elaboration of the reforms and related activities has been achieved for approximately half of the reforms, while others need further improvement. The analysis shows that eight measures (out of 20) partly respond to the requirements of sound definition of the reforms and activities, while two measures do well from the project-based perspective (elaboration of the measures) but fail to give a broader perspective of the measure (assessment: yes / partly).

One measure (enhancing cooperation between the academy and the industry) has some structure but does not clearly elaborate the substance of the measure and activities (assessment: no / partly). The need for ensuring further clarification of the reforms / measures is particularly strong with regard to the measures in the area of energy and transport reforms. In addition to the clarity and definition of the measures (as a narrow subject of assessment), it must be noted that all measures could be further improved in terms of outlining the expected results and impact assessment. That would certainly provide much stronger links of the measures with the key challenges and further coherence of the ERP.

- Most of the reform measures (16) have been fully costed, i.e. funds have been provided for the period of the ERP (2021–2023) and the projected costs seem reasonable in terms of the content of the measures and planned activities. As regards the measures that fail to show full costing, the issues are related to omitting the indication of costs for a year or two of the analyzed period (three years). On the other hand, some of them do not list activities for the years without costs; neither do they provide any explanation if the lack of activities is the reason for not costing, and if so, how the lack of activities (and costs) fits with the implementation of the measure and the results of the reform. However, the overall assessment concerning the costing of the SRs in the ERP 2021–2023 of North Macedonia is rather positive.
- With regard to the clarity / tracking of the sources of budget funding for the structural measures, it must be noted that the process of ERP elaboration in North Macedonia conditions the incorporation of the measures in the ERP with ensured funds for their implementation (if national budget contribution is planned). Therefore, in the broadest sense, all measures comply with this condition, while specific indication from which budget line the funds are allocated to the measure is not common. The specific budget line is named only in one measure, while most of the measures refer to the institution that is responsible for the implementation of the measure. The practice of budget planning and execution in North Macedonia is based on allocating the funds to the institution(s) that will implement the measure.

- Furthermore, it should be stressed that not all measures in the ERP 2021–2023 have projected national budget funding. These are assessed to comply with the clarity / tracking of the sources, as it is clear where non-budgetary sources come from. There is only one measure (introducing mechanisms for formalizing informal work in sectors with high incidents of undeclared activities) with the assessment “partly”, due to incomplete budgeting and methodological shortcomings in the budget’s setting.

In summary, the assessment of the first two categories shows that the elaboration of the measures starts with a clear note on the key or sectoral challenge to be addressed (therefore, all measures received a positive assessment), while further elaboration of the reforms and related activities vary in terms of clarity, consistency and incorporation of all the necessary aspects.

The impact assessment, in particular the quantitative one, on competitiveness and other areas identifies issues with most of the measures. This is not a crucial element of the whole assessment but needs to be taken into consideration, as a better impact assessment would contribute to a better overall definition of the reforms and their activities. Implicitly, that would result in stronger links to the challenges and overcoming the latter.

With regard to the integration of the structural measures into the FF of the ERP 2021–2023, the overall assessment of the Programme is positive.





CASE OF SERBIA

PREPARED BY EXPERT JELENA RANČIĆ

1. EXECUTIVE SUMMARY

Section 5.1 of the Serbian ERP 2021–2023 identifies the key challenges and obstacles in all eight areas, as proposed in the EC Guidance Note. However, this section elaborates more on the progress and achievements made in the past and describes the impact of the measure in the future, while the **key challenges for growth and competitiveness are presented very briefly**. On the other hand, in some areas, such as social protection and the health care system or the labor market, it seems that **significant challenges and problems targeting larger groups of population are neglected**.

The medium-term Fiscal strategy presents a comprehensive framework with very clear objectives (related to the decrease of general government deficit and debt), elaborated tax and expenditure policy measures and their impact on the fiscal and overall macroeconomic framework. It also announces changes in general and specific fiscal rules. However, **there is no clear link between financing the implementation of structural measures and the budget framework**. The transformation of the Tax Administration is the only reform that is explicitly mentioned in the fiscal section, though very generally.

Structural measures very well address the key obstacles and challenges, and most of the measures are fully costed. Out of the 24 structural measures, 17

address one or more problems identified in particular areas, and 12 measures are properly costed. The estimated costs in 2021–2023 are EUR 2.4 billion, financed mostly from project loans and IPA funds (80%), while a smaller part (14%) is planned to be allocated from the central budget.

The conclusion is that the FF accounts only for the large reforms (in terms of costs, timeline and impact), while the measures presented in Section 5 as a package are rather small, in particular when observed individually.⁴ The relatively small share of budget sources in the total costs of all measures confirms this. From total EUR 2.4 billion in 2021–2023, around EUR 341 million will be allocated from the central budget, which is probably the reason why individual measures are not referenced and explicitly mentioned in the fiscal section. Nevertheless, the estimated costs of structural measures are integrated into the FF.

For the next ERP cycle, **Section 5.1 should focus more on the key obstacles and challenges and less on the elaboration of the progress made** in previous periods. In addition, presenting a summary of Tables 10a and 10b for each year in Section 6 (instead of a text description) would be very useful for monitoring and comparing costs between different ERP documents.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED⁵

In the Serbian ERP 2021–2023, the Covid-19 pandemic is identified as one of the key obstacles, with impact on all social-economic areas, GDP growth, (un)employment and competitiveness.

In the **energy sector**, the main challenges are recognized in the current infrastructure, which creates barriers for trading energy products on the national and cross-border markets. Another important obstacle in this area

⁴ Although Section 6 provides total costs for the whole period, the reasonable assumption is that the costs of measures for 2021 could be 1/3 of the EUR 341 million budget sources. In this regard, around EUR 120 million represents less than 1% of the total expenditures envisaged in the Budget Law for 2021.

⁵ The ERP 2021–2023 does not include Section I “Introduction of the ERP”, which is why this part of the case study focuses only on the analysis of Section 5.1.

is the low level of energy efficiency. In the **agricultural sector**, the primary problems are underdeveloped rural and regulatory infrastructures as well as the unfavorable structure and technical-technological backwardness of agricultural holdings. In the **industrial sector**, the main obstacle is limited knowledge transfer between academia and industry, which hinders potential technological development, resulting in a low level of product specialization and a weaker export structure.

Furthermore, industrial policy measures in the previous period were not sufficiently focused on the key comparative advantages and needs of the Serbian economy. For the **business environment**, the key challenges are the complexity and costs of doing business as well as further increase of predictability of the business environment. The level of informal economy presents another very important challenge. Low potential in **research and science** and low financial support to innovative start-up companies in the creative industries as well as to digital transformation companies are identified as key obstacles.

One important challenge is related to the availability of e-government for businesses and particularly for citizens. Inconsistent national legislation regulating the trade of genetically modified organisms with international economic systems, primarily the World Trade Organization, is identified as one of the main barriers (in the area of **economic integration**) for the improvement of product quality and eventually for raising the competitiveness of the Serbian economy. In **education and skills**, the mismatch of educational profiles and supply with the needs of the labor market is identified as a long-term and systemic problem for the economy. Another significant challenge is related to the digitalization of the education system.

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

The Serbian ERP 2021–2023 defines the main public policy strategy as the gradual balancing and stabilization of public finances in the post-pandemic period. **The medium-term goal is to reduce the share of general government debt in GDP through the achievement of a low or close to balance fiscal deficit, or even a fiscal surplus**. This should preserve fiscal sustainability in the future and create a basis for stable economic growth. However, the strategy stresses that it is necessary to ensure the possibility of a timely and adequate response of the fiscal policy in the event of a deepening crisis.

Regarding the **labor market**, the key challenge in Serbia is to stop the emigration of highly educated people (the “brain drain”) and attract talents also from abroad. In **social protection**, the key challenge is poverty, which is still widespread and affects different categories of the Serbian population. The Covid-19 pandemic highlighted the need for a more efficient **health care system**, and the key challenge is the digitalization of the health sector.

Basically, the key challenges and obstacles are identified for all eight areas in Section 5.1, which is a good basis for further definition of structural measures and related activities in the medium term. **However, this section mostly focuses on the description of the measures and their impact in the future, and the good progress made in the past** (for the majority of the measures, as they have been rolled over from previous ERPs). **The key obstacles are identified in one or two sentences, without further detailed information on the real problems and challenges**.

In some areas, there is no focused information, rather an explanation of measures, which aggravates clear understanding of the key problems. For example, gradual introduction of a new concept of circular economy is stated but without any reference to the concrete challenge or obstacle. Some of the identified challenges (in the labor market, social protection and health care systems) are not so relevant, as they are focused on smaller groups of relevant stakeholders or processes of digitalization, setting aside real and significant problems in these important areas.

The medium-term FF envisages a moderate abandonment of the expansionary fiscal policy, particularly compared to 2020, but at the same time, the development and social programs will continue. The achieved stability of public finances, a fiscal surplus and a close to balance fiscal deficit as well as a significant decrease of the general government debt in the previous period enabled a generous and timely response of the state to the pandemic crisis. **In 2020, the package of measures estimated at about 12.5% of GDP**, in combination with monetary measures,

mitigated the negative effects of the crisis and stabilized macroeconomic developments. **The one-off increase in deficit and debt – 8.9% and 59% of GDP**, respectively – in 2020 is an inevitable consequence of the intervention measures aimed at neutralizing the impacts of the crisis.

The projections of fiscal aggregates in the period of 2021–2023 are based on the projections of macroeconomic indicators for that period, the planned tax policy that implies further harmonization with EU laws and directives, and **fiscal and structural measures**, including a further reform of large public companies. With the fiscal consolidation measures implemented in the previous period, fiscal space was created, enabling to adopt a relatively large package of measures against the impacts of the crisis caused by the pandemic in 2020. Based on that, in 2021, it was planned to use fiscal space to increase capital investments, make additional investments in the health system, moderately raise pensions and salaries in the public sector, and further decrease the tax burden. **The medium-term FF envisages a gradual reduction of the general government deficit to 1% of GDP by 2023 and a decline in the share of public debt to 56% of GDP.**

Table 3. Fiscal aggregates in 2021–2023, % of GDP

| | 2021 | 2022 | 2023 |
|-----------------------------|------|------|------|
| Public revenues | 40.4 | 40.5 | 39.7 |
| Public expenditures | 43.4 | 42.1 | 40.7 |
| Consolidated fiscal result | -3.0 | -1.6 | -1.0 |
| Primary consolidated result | -1.1 | 0.1 | 0.6 |
| General government debt | 58.7 | 57.9 | 56.0 |
| Real GDP growth rate | 6% | 4% | 4% |

In 2021–2023, the tax policy is focused on further reducing the overall tax burden on labor (tax wedge), which is expected to positively contribute to private sector competitiveness. **On the expenditure side, infrastructure and capital projects as well as pension and salary policies are given the priority.** The fiscal strategy announced changes to the Budget System Law that will contribute to the stability of public finances and the sustainability of the FF. The main changes in the law are the **redesign of fiscal rules and the definition of special measures and consequences in case of non-compliance.** There are two groups of fiscal rules that will be amended: **general fiscal rules** related to **public debt**

and the general government deficit, and **special fiscal rules on the expenditures for salaries and pensions, the largest expenditure categories.**

With regard to the SRs that are mostly financed from grants and project loans (smaller part from the budget sources), the strategy explains that the EU enlargement increases the available funds from IPA, the instrument for pre-accession assistance for rural development (IPARD) and the Sectoral Budget Support. However, there is no further elaboration on the links between concrete measures and their sources of financing. In the context of allocation of fiscal space, some structural measures are mentioned but only generally, and the link with the budget and the overall FF is rather vague. These measures include better targeting of social assistance programs, greater allocation for health and education functions, higher budgetary sources for development programs in agriculture and for SMEs, increased capital investments in water supply, sewerage infrastructure, waste management, etc.

With regard to the structural balance, the strategy determines that the overall fiscal position has significantly improved, mainly as a result of implementing large fiscal consolidation measures, such as a decrease of wages and pensions, but there is no explanation of the (potential) impact of SRs. The same applies for the projections in the period of 2021–2023, as the strategy assesses that the fiscal policy in 2020 was expansive-countercyclical (aimed at mitigating the negative economic cycle), while in 2021–2023, the policy will be generally countercyclical, which is reflected in the main goal – rapid balancing and stabilization of public finances.

The section on the quality of public finances contains important fiscal and monetary measures, envisaged by the Policy Coordination Instrument – Arrangement between the International Monetary Fund (IMF) and Republic of Serbia – but only a few are related to SRs, that is specific areas presented in the fifth part of the ERP document. Basically, this section mentions that **structural and institutional reforms** in the next medium-term period are **aimed to improve the business environment** and will focus on restructuring state-owned enterprises, financial institutions and public administration agencies, and **further reduce the grey economy.** The emphasis is on the new PFM Reform Program 2021–2025, containing public administration reforms (optimization and wage system), management of public investments, public-private partnerships, public and state-owned enterprises, etc.

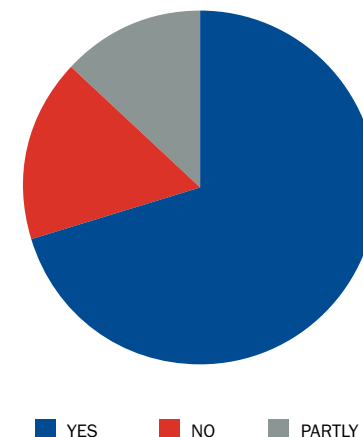
The only reform that is explicitly mentioned in this section is the transformation of the Tax Administration (No. 10 in Section 5.3). The objectives of the reform and its main activities (as presented in Section 5.3) are stated, including some additional goals and activities set out in the action plan for the transformation of the

Tax Administration in 2018–2023, which serves as a basis for preparing this measure for the ERP document. However, the whole text is very general, with no timeline, costs, sources of financing or any other relevant information provided.

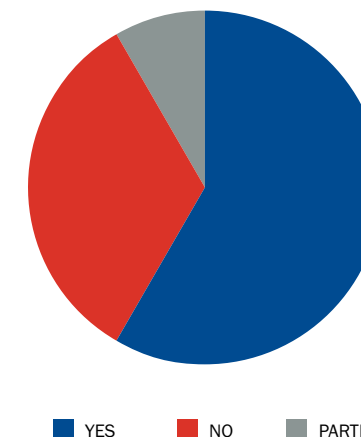
4. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

Overall, the SRs presented in the Serbian ERP very well address the key obstacles and challenges, and most of them are fully costing. Out of the 24 structural measures, 17 (over 70%) tackle one or more identified problems in the specific area, while half of the measures (58%) are fully costing.

Graph 1. SRs in relation to the challenges (%)



Graph 2. SRs in relation to costing (%)



There are four measures – two in agriculture, industry and services (5 and 8) and two in the business environment (12 and 13) – that do not address the main obstacles. For the first two reforms, the related challenges and problems are not identified, while for measures 12 and 13 there is no clear explanation or link between the obstacles to growth and the objective of the reform measure. In addition, **three of them are not fully costing**; only measure 12 includes the appropriate costing.

Three measures address the key challenges partly: measures 3 (energy and transport), 15 (RDI & digital transformation) and 24 (social protection and health systems), either because the obstacles are not clearly defined or the link between the obstacles and objectives of the measure are rather vague. Among those three, the first one is fully costing, the second one is not costing and the third one is partly costing.

It is very important to stress that **Section 5.3, identifying the key obstacles by areas, mostly focuses on describing the current status and the progress made** in the previous period / years, while the real problems and challenges for growth or competitiveness, or the social and health sectors are explained only briefly.

With regard to costing, **half of the measures (12) are fully costing**, meaning that it is clear from the text what the costs are and how they are provided for all years for which activities are planned, and there is consistency between different types of costs (salaries, goods and services, etc.) and financing sources (central budget, IPA funds, project loans, etc.). In addition, two measures (1 and 9) out of 14 are to be financed from other sources, not from the budget, while for 12 measures financing will be secured from the central budget (fully or partly from other sources).

More than 30% of the measures are not fully costed.

These are measures 5, 6 and 8 (agriculture, industry and services), 11 and 13 (business environment), 14 and 15 (RDI & digital transformation) and 22 (labor market). The reasons are the following: a discrepancy between the total costs of the reforms in 2021–2023 as explained in the text and the figures presented in Table 10a; cost estimates are not provided for the whole implementation period of the planned activities; and inconsistency of the sources of financing between the description and Table 10b.

Four measures are costed partly: measures 4 (agriculture, industry and services), 17 (RDI & digital transformation), 20 (education) and 24 (social protection and health systems), mainly because financing is secured only for 2021, while financing for 2022 and 2023 is yet to be determined.

Overall, **there is no clear and direct link with the SRs and their budgetary implications**, although they are implicitly included in the mid-term FF. Those measures that are fully costed and for which budgetary funding is provided, should be reflected in the FF, primarily in the first year based on the budget law. **Neither is there any relation with the overall sources of financing of SRs and the FF**, although general government debt projections should implicitly include expected financing from project loans, for example. Finally, **there is no summary table**

for total costs (by structure and source) for all 24 measures and each year. However, Section 6 on the budgetary implications of SRs contains description of the structure of expenditures and sources of financing for the mid-term period.

The overall costs of SRs measures in 2021–2023 are estimated at EUR 2.4 billion, around 60% of which will be spent on goods and services and 1/3 on capital investments. Over 60% of the costs will be financed from project loans, around 20% from IPA funds, and **14% will be secured from the central budget.**

As mentioned, budget resources for the implementation of structural measures in 2021 are planned in accordance with the Budget Law for 2021, while for 2022 and 2023 the resources must be planned in accordance with the allocated limits in the MTBF, meaning that financing will depend on the provision of financial resources in the annual budget laws.

Table 6. Total estimated costs of 24 SRs (EUR million)

| | |
|--------------|--------------|
| 2021 | 584 |
| 2022 | 650 |
| 2023 | 1,150 |
| Total | 2,384 |

Table 4. Estimated costs of 24 SRs, by type (EUR million)

| Period | Salaries | Goods and services | Subsidies and transfers | Capital expenditure | Total |
|-----------|----------|--------------------|-------------------------|---------------------|---------|
| 2021–2023 | 45.5 | 1,427.3 | 101.3 | 809.8 | 2,384.0 |

Table 5. Estimated costs of 24 SRs, by source of financing (EUR million)

| Period | Central budget | Local budgets | Other national public finance sources | IPA funds | Other grants | Project loans | To be determined | Total |
|-----------|----------------|---------------|---------------------------------------|-----------|--------------|---------------|------------------|---------|
| 2021–2023 | 340.9 | 17.3 | 17.3 | 480.4 | - | 1,433.7 | 94.4 | 2,384.0 |



CASE OF TURKEY

PREPARED BY EXPERT MELAHAT KUTLU

1. EXECUTIVE SUMMARY

The ERP 2021–2023 covers 26 SR measures in the eight defined reform areas that have been designed to overcome the identified structural challenges mainly by reducing import dependency in energy, increasing the production of high value-added goods, improving the business environment, eliminating skill mismatch in the labor market, and providing inclusive, effective educational and health services.

There are ongoing efforts to ensure fiscal sustainability and establish a well-structured medium-term FF by increasing the effectiveness of revenues and expenditures, keeping the budget deficit at a sustainable level, and increasing transparency and accountability needed for the effectiveness and credibility of the PFM system. In this regard, introduction of the program budget is an important step and has a close connection with the SRs in terms of establishing their link with the budget. At

this stage, there is no reference to the individual budget programs and the SRs in the FF. However, Section 6 of the ERP covers the total costs of the measures and their breakdown by cost items and sources of financing.

On the other hand, the majority of the measures have problems related to clear and exact costing as identified in the annexed Excel list and in Section 4 below. Identifying the fiscal implications and securing the funding of SRs require concerted efforts towards (1) establishing an effective medium-term FF, strengthened by the necessary improvements and adjustments, where the budget programs and the SRs are integrated and clearly documented, and (2) designing effective and efficient measures with exact and clear costing, addressing the existing challenges. In this regard, decisive continuation of the ongoing efforts with stronger ownership is of utmost importance.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

Sections 1 and 5.1 of the ERP identify the following key challenges:

- Rapid demand growth and import dependency in the energy sector
- Tensions and uncertainties in trade and postponement of update of the Customs Union between Turkey and the EU
- Lack of comprehensive data sets needed in the food supply chain for ensuring food safety and security
- Sea-sand-sun (mass tourism) image of Turkey as a tourism destination
- Inability of the business environment to increase the competitiveness of SMEs
- Informality
- Intensive need for increasing productivity by supporting the necessary transformation of the industrial infrastructure to serve the economies of scale and contribute to RDI and digital transformation

- Inequalities in education, especially in distance education
- Skill mismatch in the labor market (adapting vocational training in the most appropriate way and bringing technology-appropriate qualifications to the labor force)
- Low level of participation of women and youth in employment
- Need for more inclusive, high-quality and efficient education and health services

There is great consistency in terms of specifying the related obstacles between Sections 1 and 5.1 of the ERP. The identified obstacles are relevant to the current situation in Turkey and well in line with those specified by the EC assessment report. On the other hand, a structured approach is missing and obstacles are not stated clearly for all the cases, e.g. the “need for

inclusive, high-quality and efficient education and health services” which is derived from the identified priority steps to be taken by the ERP. It can be said that there is a shortcoming related to coverage and focus in the case of education. The inequalities in education (especially in distance education) have been emphasized extensively, while the need for improving overall quality is not

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

I. FISCAL POLICY STRATEGY AND MEDIUM-TERM OBJECTIVES

The main objective is to protect the strong and sustainable structure of public finance. Fiscal policy will be implemented in a way that contributes to increasing the growth potential, inclusive and sustainable distribution of welfare, keeping the current account deficit at a sustainable level, and encouraging domestic savings and investments, while also taking into account harmony with monetary policy targets.

In this regard, the revenue policies implemented in 2021–2023 aim at increasing efficiency in tax collection and incentive and support systems, enhancing the effectiveness of monitoring and auditing by using digital technologies and fighting against informality, as well as gradually abolishing ineffective tax exceptions and reductions. As for expenditure, the multi-year budgeting approach, effective expenditure reviews, efficiency of expenditure programs, effectiveness of incentive and support programs, use of public immovable, idle facilities for employment and production are the main features of the policy foreseen for the three-year period.

The principles for borrowing include following a sustainable, transparent and accountable debt management policy, meeting financing needs at the optimal cost level and under the net borrowing limit defined by the law, borrowing mainly in TL, borrowing in foreign currencies besides US dollar in international markets for market diversification, maintaining the share of debt maturing within 12 months, and keeping a certain level of cash reserve to reduce the liquidity risk associated with cash and debt management.

In PFM and auditing, the program budget system has been designed to support fiscal discipline by improving spending priorities to better meet the expectations of the society, strengthen the link between public resources and public services, and enhance transparency and accountability. In this scope, 68 programs have been identified. The budget law proposal for 2021 was prepared in line with the program budget and submitted to

expressed clearly, apart from a general phrase stated as a future step in the first section of the ERP (the last item in the above list). Similarly, social inclusion and combating poverty issues are touched upon briefly by pointing out only immigration related problems. There is no specific reference to social protection, inclusion and health in Section 5.1.

the Parliament together with the administrations’ performance programs. In the meantime, the analytical budget classification that is largely in line with the international classification will continue to be used. The administrations will continue to draft strategic plans, performance programs and year-end reports.

II. BUDGET PLAN FOR 2021

The central government budget expenditure is TL 1,346.1 billion in the 2021 budget plan, representing 23.2% of GDP, 1.6 points above the previous year. Expenditure figures are specified under the headings of interest payments, personnel expenditures, state social contributions, current expenditures, current transfers, capital expenditures, capital transfers, lending and reserve appropriations. In this context, respective expenditure amounts and their ratios to GDP, and comparisons with the previous year’s corresponding figures are discussed, and related increases and decreases are explained

As for the central government budget revenues, the targeted total revenue is TL 1,101.1 billion. In the light of revenue estimation and the projected expenditure size, the predicted budget deficit is TL 245.0 billion or 4.3% of GDP. The ratio of central government budget revenues to GDP in 2021 is estimated at 19.5% of GDP, that is 0.6 points below the realization estimate of the previous year. Non-tax revenues are expected to decrease by 0.6 points and tax revenues to increase by 0.04 points.

III. MEDIUM-TERM PERSPECTIVE

General government revenue and expenditure estimates in the macroeconomic framework, as set out in the medium-term economic program, are based on the following objectives: ensuring fiscal discipline by limiting public expenditures, increasing efficiency and savings in current expenditures, enhancing the effectiveness of incentives and state aids, expanding the tax basis and efficiency in tax collection, avoiding temporary resources for permanent expenditures, and determining state-owned enterprises’ price policies in line with the medium-term program targets.

IV. STRUCTURAL AND CYCLICAL GENERAL GOVERNMENT BALANCE

As defined by the ERP, the actual general government balance covers the temporary impacts of economic fluctuations as well as the one-off measures taken. However, the structural general government balance, which has become crucial with establishing the multi-year budgetary process, reflects the revenue and expenditure levels under the assumption that the economy is operating at its potential level. Changes in the structural balance are a useful indicator in terms of fiscal policy interpretation. Policy implementation either amplifies (procyclical) or dampens (countercyclical) the cycle. The positive association of changes in the structural balance with changes in the output gap implies a countercyclical fiscal stance; a negative association implies a procyclical fiscal stance.

For the period of 2021–2023, it is foreseen that the mentioned relation will be positive for the first two years, so the projected policy implementations will dampen the economic cycle. However, it will be negative for 2023. Budgetary resources are aimed to be used effectively in line with the allocation priorities determined. With the transition to the program budget system, which will increase the efficiency of the public service delivery and the administrative structure as well as accountability and transparency, monitoring the effectiveness of the use of public resources will be ensured. Thus, it is expected that the general government balance will be on an upward trend, and the ratio of actual and structural general government deficit to GDP and potential GDP consecutively are expected to be 4.7% and 4.3% on average in the ERP period.

Similarly, it is expected that the actual and structural primary general government balances, which turned into deficits in recent years, will be on an upward trend in the three-year period, with the contribution of the measures taken, compared to previous years. However, both the actual and structural primary general government balance to GDP and potential GDP consecutively, which were estimated at –0.5% and –0.2% on average in the previous ERP period, are expected to be –1.4% and –1% on average in 2021–2023.

V. QUALITY OF PUBLIC FINANCES

There are quite a number of measures in the related high-level policy documents aiming to rationalize public expenditures and increase the quality of revenues. The most important of these measures are the transition to the program budget structure and the execution of spending reviews.

The necessary work for the transition to the program budget system was completed in 2020. The 2021 Central Government Budget Law drafted in accordance with the program budget was presented to the Grand National Assembly of Turkey (TGNA). In the same way, administration performance programs were designed in accordance with the program budget and submitted to the TGNA. In the upcoming period, the implementation results of the program budget system will be monitored and improvement studies will be carried out.

In addition to achieving effective fiscal tightening in the medium term, spending reviews have started, which are a convenient instrument for new policies to be established to ensure efficiency in resource allocation and equality in income distribution. The purpose is to make use of this instrument in designing policy measures regarding various types of expenditure, tax reforms and tax expenditures. In this regard, activities are carried out to increase institutional capacity, formulate guidelines and draft study reports.

As stated above, efforts are made to ensure a strong and sustainable public finance structure, with the aim of contributing to the growth potential, the inclusive and sustainable distribution of welfare, keeping the current account deficit at a sustainable level, and encouraging domestic savings and investments, with the accompanying monetary policy targets. In this context, the importance of the program budget has been stressed repeatedly for the sake of increasing the effectiveness of expenditures in meeting the needs of the society and enhancing transparency and accountability.

The program budget structure has been introduced by the 2021 central government budget law, and 68 programs have been submitted to the Parliament together with institutional performance programs. However, there is no further information about the budget programs or the SRs in the FF of the ERP. Budget programs with detailed descriptions and costing at sub-program and activity levels, and links to the budget, would pave the way for establishing a clear link between the SRs and the FF, since the SRs are to be integrated into the budget programs in one way or another.

4. STRUCTURAL REFORMS AND THEIR INTEGRATION WITH THE FISCAL FRAMEWORK

The ERP includes 26 measures in total; two of them are composed of two parts and presented as separate measures. Therefore, 28 measures have been examined in this analysis, based on the given criteria. The overall quality of the definition of measures is quite good, even though there are some shortcomings related to the issues specified by the assessment criteria as explained below.

The defined measures address the key and sectoral challenges identified in the ERP, although some of them, like Establishing SME Guidance Counseling System and Dissemination of Pre-school Education, have a limited focus on eliminating the problems. Therefore, they are scored as partly.

Clear definition / description of the activities is one of the major problems. Ten measures out of 28 are scored as a yes. Two measures are scored as a no: Increasing the Share of Renewable Energy Regarding Electricity Generation and Dissemination of Family-Oriented Social Services. As regards the former, the reform should be presented in a more structured, clear and simplified way. For example, background information constitutes a large part of the measure description and activities, including in the costing section, which creates confusion. The focus on the measure itself is rather limited. Besides, it is not clearly stated what kind of changes will be introduced by the new legislation. In the latter, the activities are rather presented in the form of indicators, e.g. “the number of children benefiting from the Social and Economic Support service will be increased”.

The rest of the measures, 16 out of 28, are scored as partly, meaning that the defined activities are not clear and comprehensive enough. Activities can be regarded as the backbones of the measures, since they are closely linked to the timely achievement of the results, and the exact and true identification of the required means / sources. Relevant improvements would increase the overall quality of the measures to a great extent.

As for clear costing, only eight measures out of 28 qualified as a yes. Two measures (reducing unregistered employment and job clubs) – even if they are scored as a yes for the activity description – are partly costed, meaning that there is no full consideration of the activities in costing. As regards renewable energy, even if it is stated in the description that the measure would not impose any additional cost since it is a legislative ar-

rangement, some unclear cost figures are stated at the end of the cost description and in Table 7b for goods and services and capital expenditures, reflecting confusion. Therefore, it is scored as a no for costing. In the case of preschool education measure, the activities are scored as a yes and so is costing, reflecting the judgment that the cost figures are appropriate on the basis of the stated activities. However, they might be lacking the recruitment of teachers. As for the measure on family oriented social services models, the description and activities are scored as a no, while the costing is scored as partly. However, some lump sums are stated as costs; the coverage of social assistance programs and related activities are unclear.

In total, 18 measures are scored as partly for clear costing, meaning that the details of the activities and / or cost categories are not taken into account in total cost calculations. In general, lump sums are stated without providing any details of the composition of costs. But even then, as stated in the related brief explanations, it would be useful to identify the cost categories, such as consultancy services, personnel, equipment and RDI expenses, according to the coverage of individual support programs and cost them separately. In light of the situation analysis of the related criterion, it is difficult to say that the measures are costed exactly and clearly.

As for the clarity of budgetary fundings for the reform to be provided, for all additional cost imposing measures they are stated either in the measure description or in Table 7b. The budgetary fundings are secured by the Presidency of Strategy and Budget (PSB) and the Ministry of Treasury and Finance. Public institutions' budgets covering capital, current and transfer expenditures are approved by the PSB by respecting the institutional appropriation ceilings set out in the medium-term budget program. In this context, public capital expenditures are covered by annual investment programs prepared by the PSB in line with the institutional budget appropriations. In parallel to this process, SR measures are developed / identified by the institutions and related approvals and resource allocations are done by the PSB. However, there is no clear documentation open to the public regarding resource allocations for individual measures. Therefore, the cost imposing measures are scored as partly. Nevertheless, related funding statements can be specified by clearly stating the institutions (for the central budget), funds (for other national resources), local governments and external funds.

Section 6 of the ERP gives an assessment of the total cost and financing of the SRs. Approximately EUR 1.3 billion of additional costs are envisaged for the total of 26 SR measures to be implemented. Transfers have the highest share of about EUR 1.2 billion. 93% of the cost items consist of subsidies and transfers, 3% of capital expenditure, 3% of goods and services, and 1% of salaries. Considering the financing sources, 95% of the additional costs will be financed from central budget resources.

There are ongoing efforts to ensure fiscal sustainability and establish a well-structured medium-term FF by increasing the effectiveness of revenues and expenditures, stabilizing the government debt at a sustainable level, and increasing transparency and accountability needed for an effective and credible PFM system. The introduction of the program budget is an important step and has a close connection with the SRs in terms of establishing their explicit link with the budget. At this stage, there is no reference to individual budget programs and SRs in the FF of the ERP.

The majority of the measures have problems with the clear and exact costing as identified in the annex. Identifying the fiscal implications and securing the funding of SRs require concerted efforts towards (1) establishing an effective medium-term FF, strengthened by necessary improvements and adjustments in the budget programs, including detailed descriptions and costing at sub-

program and activity level, and integration of the SRs, and (2) designing effective and efficient measures addressing the existing challenges, with exact and clear costing. Therefore, decisive continuation of the ongoing efforts with stronger ownership is of utmost importance.

It should also be said that no measures have been abandoned due to the lack of finances but failures relate to designing ineffective measures and lack of accountability. As concerns the measure descriptions, some measures (e.g. measure 1) include overlapping information in the different sections / headings of the measure. So, there is a need for a more systematic and structured approach in measure description and design.

Last but not least, the identified reform areas of some measures should be changed, such as measure 4 relating to the replacement of inefficient electric motors and measure 20 regarding occupational health and safety, as the related structure and result indicators are addressing the energy sector for measure 4 submitted under industry, and health for measure 20 submitted under education and skills. For measures 12 and 17, which are composed of two parts, the link and complementarity between their sub-measures should be clearly justified and explained. As a final remark, the SRs scoring is deemed more subjective, especially in “partly” cases, as the coverage and extent might be perceived / judged differently.



ANNEXES

ANNEX 1: TEMPLATE FOR CASE STUDIES

The case studies should consist of the five chapters listed below and should be based on the analysis of the ERPs for 2021–2023.

1. EXECUTIVE SUMMARY

[STRICTLY NOT MORE THAN 0.5 PAGES]

Provide a short summary of key findings from each of the sections below (a paragraph for each section).

Conclude with your overall assessment of how well, in your opinion, the SRs as a whole are integrated into the FF of the ERP (for example, do the FF and SRs, taken together, constitute a well-designed policy mix which is likely to successfully address the key challenges / obstacles to growth?).

Highlight the main positive features of the ERP as well as the most significant challenges you identified (with respect to the integration of SRs into the FF). Add your recommendations (if any) on how to improve the integration in the next ERP.

2. KEY CHALLENGES / OBSTACLES TO GROWTH IDENTIFIED

[UP TO 1 PAGE]

[Analyze Sections 5.1 (Update on key obstacles) and I (Introduction) of the ERP.]

Provide information on which key challenges / obstacles to growth are identified in the ERP – list all the challenges / obstacles mentioned in these sections but do not go into any more detailed explanations of the key challenges. Also do not list the challenges that are only mentioned in Section 5.3 (Analysis by areas and reform measures).

Conclude with your observations / comments on how well the obstacles are defined – are they clear, well justified and structured, focused (i.e. not too many), and relevant – and whether Sections 5.1 and I are related and consistent with one another.

3. FISCAL FRAMEWORK AND INCLUSION OF STRUCTURAL REFORMS

[UP TO 3 PAGES, DEPENDING ON THE NUMBER OF SRS REFERENCED IN CHAPTER 4]

[Analyze Sections 4.1 (Policy strategy), 4.3 (Budget plans for the submission year), 4.4 (Medium-term budgetary outlook), 4.5 (Structural balance) and 4.8 (Quality of public finances) of the ERP.] Shortly summarize the key features of the ERP’s fiscal strategy and the FF for the next three years. Identify any reference to SRs in these sections. Provide information which reforms are referenced and how (i.e. what is said about them), separately for each reform mentioned.

Conclude with your observations / comments on how well the fiscal strategy and framework incorporate at least some of the SRs. For example, are (some) reforms mentioned as important for implementing the fiscal strategy, or as having a large fiscal impact or risk, or whether an explanation is given on how the fiscal space for the funding of reforms will be created.

4. STRUCTURAL REFORMS AND THEIR INTEGRATION INTO THE FISCAL FRAMEWORK

[2-3 PAGES]

[Analyze Sections 5.2 (Summary of reform measures), 5.3 (Analysis by areas and reform measures) and 6 (The cost and financing of SRs) of the ERP.]

First, complete the SRs Integration Scoreboard in the Annex. Based on the scoreboard and your analysis, provide your observations / comments on how well the presentation of SRs, as a whole, is linked with:

- FF (i.e. fully costed with well specified and secured budgetary funding),
- The challenges / obstacles (i.e. clearly defined and linked with the key or sectoral challenges / obstacles to growth).

In the text, give examples of SRs that highlight (substantiate) your observations and comments.

5. ANNEX: STRUCTURAL REFORMS INTEGRATION SCOREBOARD

This annex should be submitted in a separate Excel document. Fill in the tables for each SR listed in Chapter 5 of the ERP 2021–2023 The assessment of each SR must be based on the methodology explained in Section II of this paper.

| # | Name of the reform in the ERP | ERP sector | Sector Name |
|---|-------------------------------|-------------------|---------------------------------|
| Reform name | | Assessment | Brief explanation of assessment |
| 1. Is it clear which key or sectoral challenge / obstacle to growth the reform is addressing? | | Yes / No / Partly | |
| 2. Are the reform and activities clearly defined? | | | |
| 3. Is the reform fully costed? | | | |
| 4. Is it clear from which budget line, program or institution’s budget the budgetary funding for the reform will be provided? | | | |

ANNEX 2: THE STRUCTURAL REFORM INTEGRATION SCOREBOARD



Q1: IS IT CLEAR WHICH KEY OR SECTORAL CHALLENGE / OBSTACLE TO GROWTH THE REFORM IS ADDRESSING?

YES – if challenges are clearly identified in the general analysis in Chapter 5 or in the sectoral analysis, and it is clear which of these challenges are addressed by the measure – either clearly stated so or obvious from reading the measure and challenges.

NO – if the measure is not connected to challenges, or the challenges are not identified at all.

PARTLY – if it is clear which challenges are meant to be addressed but you think that the measure is too weak or too poorly specified to be able to address these challenges in any important way.

Notes:

- Not all challenges can be addressed by one measure.
- Challenges in the “Social protection and inclusion, including health” section do not need to address challenges to growth or competitiveness but those related to the social situation
- When it is said that the SR addresses one of the key challenges from the EC assessment report, you need to check whether there is indeed a link between the SR and the challenge identified in the EC assessment.



Q2: ARE THE REFORM AND ACTIVITIES CLEARLY DEFINED?

YES – if it is clear from the description of activities what will be done, when and by whom.

NO – if most activities are not clear (what will be done, when and by whom).

PARTLY – if some activities are clear and others not, or if some activities which would be expected from the description of the measure are missing.

Notes:

- We are not asking about the quality of the SR here. You may think that the listed activities are not the best ones, are insufficient or too many, etc. but as long as they are clear, the answer should be YES.
- Note that the ERP may only include the activities of ERP implementers, i.e. when some actions are expected from non-government stakeholders, these do not need to be included in the list of activities.



Q3: IS THE REFORM FULLY COSTED?

YES – if it is clear from the reading what the costs are, the estimation of costs seems realistic and is provided for all years for which activities are planned.

NO – if it is not clear what the costs are.

PARTLY – if only some of the costs are clear, or if they seem too high or too low compared to the planned activities, or there are discrepancies between the text about costs and figures in Table 10a.

Notes:

- In ERPs, costs are not required to be specified for each activity separately, and a detailed explanation of how the costs were calculated is not necessary.
- For some SRs, ERPs give quite a detailed description of costs but if not, you will have to judge whether all the important costs are included. To check the realism of costs, the best way is to read the activities of the measure, think which are the costliest ones, then read the text about costs and Table 10a, and see if based on all this you can say that all costs are accounted for. [For example, there were quite a few cases detected when the costing of the reform focused on the technical assistance and completely ignored the costing of the “real measure”. For instance, if a platform is to be set up or some subsidies granted to firms, then the cost of EUR 30,000 per year does not seem to be a full cost, as the bulk of the cost is missing.]
- When the ERP says that there are no additional costs for the measure and you can confirm that this is true (e.g. all activities will be implemented by existing personnel), the answer is YES.
- In one ERP, Tables 10a and 10b are missing. In this case, the answer can be YES only if all the costs are clearly explained in the text.



Q4: IS IT CLEAR FROM WHICH BUDGET LINE, PROGRAM OR INSTITUTION'S BUDGET THE BUDGETARY FUNDING FOR THE REFORM WILL BE PROVIDED?

YES – if the text on costing mentions the **location of the funding** for the SR in the budget (a budget of a ministry or agency, a fund, a budget program or a specific budget line) and states that the necessary funding is **available**.

NO – if it is only said that the funding will be provided from the budget, or if the amount of budget funding is given but **without any further specification**.

PARTLY – if the location of funds in the budget is mentioned **only for a part** of budgetary funding, or if it is **not stated whether the funds are indeed already planned** for in the budget or Medium Term Expenditure Framework (MTEF), or if there are **discrepancies** between Table 10b and the text.

BLANK (NO ANSWER) – if no budget funding is planned for the measure.

Notes:

- If information on the location of funds in the budget is not provided but you are aware that the MoF checks the costing and that a SR cannot be included in the ERP unless budgetary funding is secured, the answer is YES.
- If only Tables 10a and 10b are filled in, without any specific information on budgetary funding, the answer is NO. [Note that the categories of costs in Table 10a (goods and services, subsidies and transfers, etc.) are not budget lines.]
- We are only asking about the part of funding which is to be provided from the budget. However, when the total funding from all sources in Table 10b is lower than the total sum of costs in Table 10a, indicate this in your comment to the score.



MY NOTES



MY NOTES



MY NOTES

ABOUT THE CEF

The CEF is an international organization with the mission to support capacity development of public officials and their institutions in South East Europe through learning and knowledge sharing. We combine topical expertise with in-depth knowledge of countries in the region in the thematic areas of public financial management, tax policy and administration, central banking, and cross-cutting areas of data and analysis for designing policies and leadership for managing reforms.

Another important focus of our activities is support to our member institutions in becoming knowledge hubs and learning organizations.

**Line
Ministries
Portal**

Join your peers on the Line Ministries Portal and exchange knowledge:

www.lineministries.org