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

Delegations will find attached the Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey.

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

The Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, Brussels, 17 May 2019

Representatives of the EU Member States, the Western Balkans and Turkey, the European Commission and the European Central Bank, as well as representatives of the central banks of the Western Balkans and Turkey[1] met for their annual economic policy dialogue[2]. The submitted 2019-2021 Economic Reform Programmes (ERPs) of the Western Balkans and Turkey outline the medium-term macroeconomic and fiscal framework as well as structural reforms to enhance competitiveness and long-term growth. Participants regretted that Turkey's ERP had been submitted with some delay.

Participants took note of the Council Conclusions of 26 June 2018 on enlargement and the stabilisation and association process and the European Council's endorsement of said Conclusions. The dialogue on economic governance with the Western Balkans and Turkey is meant to prepare them for their future participation in the EU's economic policy coordination procedures. The dialogue reflects to some extent the European Semester process at EU level. Ownership is key to achieve the results envisioned in the ERPs and the jointly agreed policy guidance.

Participants recalled the commitment to set out a new set of targeted policy guidance to support efforts towards fulfilling the Copenhagen economic criteria. In this context, Participants agreed that the elements of the 2018 policy guidance which had not yet been fully implemented remained valid and needed to be addressed by policymakers in the Western Balkans and Turkey.

Overall, Participants underlined their commitment to this surveillance process, which should ensure a continued anchoring of medium-term economic programmes and commitment to structural reforms by the Western Balkans and Turkey. Participants encouraged the Western Balkans and Turkey to continue to improve their macroeconomic, budgetary and structural policies. Participants also noted the links between such progress and the rule of law, the improvement in economic governance and the judiciary system. Participants agreed on the critical importance of foreign direct investments not undermining socio-economic and financial sustainability. Particular attention should be paid to the risk of excessive indebtedness and in particular in the Western Balkans to the transfer of control over strategic assets and resources. The authorities must ensure the full transparency of all investments, in particular those involving public procurement procedures. The dialogue will continue in 2020, including on the implementation of these conclusions.

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[1] Montenegro, Serbia, the Republic of North Macedonia, Albania and Turkey are candidate countries for EU accession.
[2] The conclusions of this dialogue are without prejudice to EU Member States´ positions on the status of Kosovo.

Turkey

Turkey submitted its Economic Reform Programme 2019-2021 on 13 February 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been implemented to a limited extent.

Turkey's domestic financial conditions sharply worsened in the third quarter of 2018 following volatile capital flows. The output growth deceleration of the second quarter turned into a recession in the last quarter of 2018. Turkey's large dependence on foreign finance, high past credit growth and the need to repair corporate balance sheets suggest protracted economic headwinds. The ERP expects a strongly positive net trade contribution to kick-start a recovery in 2019 that will fully gain traction in 2021. There are substantial risks to this outlook. High inflation, on the one hand, shifts the debt burden from debtors to creditors and on the other hand risks a more permanent rise in inflation expectations feeding an adverse wage-inflation dynamic. In addition, the current account deficit, which has adjusted sharply as a result of the rebalancing process, is likely to increase again in the medium term as domestic demand recovers while Turkey still depends on more volatile forms of capital flows, exposing it to shifts in market sentiment. Government debt is relatively low, and fiscal policy credibility built up over the years, along with monetary tightening and an overall sound banking system, have been the main reasons for Turkey to weather the financial turmoil to date. However, recent years have seen a slack in public finances and the ambitious fiscal consolidation agenda is heavily front-loaded. Risks to the budget plans are the relatively optimistic projections for economic growth and revenues at a time when spending pressures are emerging. In this respect, the government should implement without delay the reform announced to widen the fiscal base in order to increase fiscal revenues. Turkish budgetary policymaking would still benefit from higher transparency and better fiscal governance. In response to the crisis, Turkey took unorthodox measures. A clear exit strategy is necessary to avoid a permanent undermining of the functioning of the market economy.

Regarding financial stability, the slowdown of the economy coupled with the depreciation of the lira resulted in rising credit risk, with the banking sector's ratio of non-performing loans (NPLs) to total loans increasing albeit from low levels. Moreover, the regulatory NPL ratio might understate the extent of asset quality impairment due to a number of recent measures *inter alia* to facilitate loan restructurings aiming to prevent corporate default. Overall, the banking sector appears to have some buffers as its capitalisation continues to be well above minimum standards. Indirect credit risk stemming from the high share of corporate forex lending and external debt denominated in forex remain the main risks to financial stability (as became evident during 2018). At the same time, banks were able to roll over at least parts of their external funding also in the context of the currency depreciation. Measures announced by the government to strengthen the financial situation of public and private banks and to tackle the NPL issue are welcomed and should be implemented as soon as possible.

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) improving transparency and predictability in the regulatory and institutional environment affecting businesses, (ii) formalisation of the economy and (iii) raising the performance level of the education system. Measures taken after the 2018 lira crisis had a negative impact on the business environment. Changes made in the regulatory environment against unforeseen conditions had an adverse effect on the predictability of the business environment. In addition, the competitiveness of the economy is particularly hindered by the large informal sector. Some progress has been made, notably with the lifting of the state of emergency.

However, further efforts are needed. The further development of a knowledge-based economy requires improving the quality and coverage of education at all levels; this is also key for increasing labour market participation, in particular making better use of the labour market potential of women and youth. Social dialogue has deteriorated and its potential for employment and social policy is not used.

Participants welcome that Turkey made substantial progress in applying EDP methodology and in quarterly government finance statistics, and increased the delivery of labour market and research and development statistics. Efforts are still needed to further improve annual and quarterly national accounts, balance of payments, international investment position, and labour market statistics and address the remaining methodological challenges.

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

1. Promote domestic savings by following a sufficiently tight fiscal stance over the medium term and by reducing government credit guarantees and other incentives that increase the financial leverage of the corporate sector and strictly limit them to market failures. Further incentivise net savings of the household sector.
2. Enhance the prudence and transparency of fiscal policy by publishing a comprehensive inventory of risks to public finances stemming from Public Private Partnerships and other contingent liabilities as part of the budgetary process. Limit the accumulation of new contingent liabilities from public-private partnerships by using strict cost-benefit analyses. Prepare an options paper on introducing numerical fiscal rules and establishing an independent fiscal body.
3. Focus monetary policy on the pursuit of price stability and ensure that the monetary policy stance is sufficiently tight to bring inflation back to the target band, anchor inflation expectations and increase trust in the local currency. Publish the methodology and specific outcomes of the next asset quality review in a more transparent and detailed way in line with international standards. Ensure that no impediments to non-performing loan resolution exist to foster the clean-up of impaired assets, and explore potential further measures in order to address risks associated with corporate foreign currency borrowing.
4. With the view to improving the business environment, strengthen the rule of law and stabilise the business regulatory environment, including by improving efforts to reduce the number of companies remaining under trusteeship without jeopardising lawful process; unwinding of the measures to contain temporary financial market volatilities that might hinder the free flow of foreign currency; and reducing the share of goods in the Consumer Price Index basket for which prices are directly or indirectly influenced by the government.
5. Further reduce informality in the labour market, *inter alia* by strengthening inspection capacities, and by evaluating the impact of social security and tax incentives aiming to strengthen the transition to formal employment.
6. Ensure full enrolment for 5 year-olds in mandatory pre-school education. Ensure full enrolment and improve curricula in secondary education, including the provision of vocational education and training. Incentivise female labour participation by providing public and private childcare facilities and tax and social security incentives for formal employment, especially in female-dominant sectors and for part-time work.

Montenegro

Montenegro submitted its Economic Reform Programme 2019-2021 on 31 January 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been implemented to a limited extent.

After recording several years of strong economic performance, the ERP projects a moderation in output growth to around 2.5 % on average in 2019-2021. The baseline growth scenario appears plausible in the current context. It assumes a moderation of the level of investment after the completion of a major infrastructure project, and slower pace of private consumption due to weak growth in employment and wages. New capacities in the tourism and energy sector are expected to sustain a moderate expansion of exports. Import growth is seen as declining in parallel with the turn in the investment cycle. This is projected to reduce the very high current account deficit, which is expected to be largely financed by foreign direct investment. Fiscal policy targets have been softened compared to previous year's programme. Budget expenditure is expected to decline markedly following the completion of the first section of the Bar-Boljare highway, which is set to swing the budget into surplus and reduce public debt from its peak of 71 % of GDP. The long-term sustainability of public finances depends on controlling the costs of the large non-discretionary items of the budget, like wages and pensions. However, reforms to contain such spending have been delayed. Recurrent deviation from budget targets reveals challenges in fiscal governance.

While overall financial stability metrics are favourable, some smaller banks appear to struggle with maintaining operational viability, calling for the central bank to continue to use its supervisory powers when warranted. In addition, fostering consolidation in the banking sector could be beneficial. Banks' non-performing loans (NPLs) have declined to more manageable levels in recent years. However, a sizeable amount of NPLs remains concentrated in factoring companies. Therefore, a more holistic approach than the measures pursued to date to address non-performing exposures is warranted. A comprehensive asset quality review is necessary and the central bank should make use of its mandate to supervise factoring companies. In addition, legal, judicial or institutional bottlenecks, particularly outside the remit of the central bank, should be tackled to arrive at a rapid and comprehensive restructuring of non-performing debts.

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) strengthening the regulatory environment, (ii) formalisation of the economy and (iii) increasing labour market activity. The conduct of business is particularly affected by the non-consistent and sometimes conflicting implementation of laws between different authorities on central and local level. Many of the policy-making processes do not provide the necessary transparency level and equal opportunities to all stakeholders. In particular, secondary legislation impacting on business environment is usually not subject to public debate and scrutiny and often adopted with significant delays. The large informal sector is fuelled by the weaknesses of the regulatory environment, including the labour market and high tolerance for tax non-compliance. Some progress was made, notably on simplifying, structuring and lowering the number of administrative fees for businesses. However, further efforts are needed in these areas. Low labour market activity remains among the key structural challenges, particularly for youth, women and the low-skilled. Weak job creation, labour market regulation and taxation, and undeclared work negatively affect employment. The gender employment gap is high and low coverage of childcare further compresses labour market participation of women. Labour market transitions are also hindered by skills mismatch, weak educational outcomes and limited re- and upskilling measures. Productivity and nominal wages are barely increasing. The average real wage has been decreasing in 2018. Employment services and active labour market policies do not cover jobseekers and their needs effectively enough. The social protection system still lacks activation capacity and has a weak capacity to target those most in need. Low employment, demographic changes and short working lives put pressure on the pension system. The potential of social dialogue is not yet fully used.

Participants take note that Montenegro made progress in several statistical areas such as national accounts, energy statistics, foreign direct investment and short-term statistics, and is committed to improve the coverage and accuracy of quarterly national accounts. Montenegro should give priority to the transmission of EDP notifications and government finance statistics and aim for a full implementation of the European system of Accounts 2010.

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

1. Use windfall gains, such as proceeds from privatisation and airport concessions, to accelerate the reduction of the general government debt ratio. Broaden the tax base by introducing an electronic fiscal invoice system. Reduce the public sector wage bill as a share of GDP by fully implementing the public administration optimisation plan at the central and local self-government level, including a system of centralised payroll calculation.

2. Reinforce fiscal governance by introducing medium-term budgetary planning and programme budgeting. Advance the reduction of arrears at local level, including those of municipal companies. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultation with stakeholders, including the EU.

3. Strengthen efforts to resolve the remaining stock of non-performing loans, including those held outside the banking system, and address obstacles hindering resolution outside the responsibility of the central bank. Conduct a comprehensive asset quality review of the financial sector in line with international best practices and publish the results. Closely monitor risks related to the consumer loan segment, deploying appropriate micro- and macroprudential policy tools if needed, and consider measures to bolster the resources at the disposal of Montenegro's deposit insurance fund.

4. Improve the regulatory environment by developing publicly available guidance on the practical implementation of each law that affects the business environment. Ensure consistent application of the provided guidance.

5. Develop a comprehensive strategy providing reliable benchmarking tools allowing for the continuous assessment and reduction of the informal economy, including undeclared work. Ensure close cooperation between central and local authorities to reduce the informal economy. Adopt and implement the new legislative framework on public procurement, public-private partnerships and concessions.

6. Increase labour market participation, in particular for youth, women and the low skilled, by strengthening employment activation measures, including through better provision of upskilling and reskilling measures. Improve coordination between employment and social services. Establish a solid monitoring and evaluating mechanism on the implementation and results of practical learning at vocational and higher education.

Serbia

Serbia submitted its Economic Reform Programme 2019-2021 on 31 January 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been partially implemented.

The ERP's baseline economic outlook is broadly plausible, although some of its elements are less certain. It expects the economy to expand steadily at 3.5 % - 4.0 % in 2019-2021 due to solid growth in export, private consumption and investment. Short-term economic prospects, however, have worsened mainly due to the slowdown of external demand from main trading partners. Inflationary pressures are low and the central bank conducted monetary policy in line with achieving the inflation target. Due largely to continued strong revenue performance, the general government budget was again in surplus last year. The fiscal strategy envisages a reduction of government debt below 50 % of GDP through broadly balanced budgets. However, the growth-enhancing policy measures in the 2019 budget are too modest and there is scope to increase capital spending. Good fiscal results are not yet sufficiently anchored, as important reforms such as the public wage system reform have been delayed. Fiscal governance remains weak and work on strengthening fiscal rules has largely stalled. Furthermore, the current demographic trend could threaten the long-term fiscal sustainability.

The banking sector remains well capitalised and liquid according to several metrics, and vulnerabilities stemming from poor asset quality have been significantly reduced. In particular, the ratio of non-performing loans (NPLs) to total loans has declined considerably since 2015 and credit growth appears to have resumed for both corporates and households. Moreover, in some segments lending increased fast, and the central bank adopted a set of regulations in order to prevent a build-up of risks stemming from excessive cash lending at long maturities in December 2018. NPLs in State-owned banks where restructuring is progressing slowly have also declined, but still remain high. The measures taken by the authorities within the dinarisation strategy adopted in 2012 and updated at end-2018 have yielded positive results. However, progress has been slow and uneven across segments. In particular, while deposit dinarisation has been gradually increasing, enhancing corporate lending dinarisation has proved more difficult, indicating that currency-induced credit risk (CICR) still represents a financial stability risk.

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) improving transparency and predictability in the regulatory environment and facilitating competition, (ii) tapping renewable and energy saving potentials and fully opening the energy market and (iii) increasing the contribution of labour to growth. Private and public investment remain low, although progress has been made during last several years. There is a strong sense of unfair competition primarily fuelled by large and inefficient state-owned enterprises, the large informal economy and the large state aid schemes for FDIs. In the energy sector, finalisation of reforms is key, especially as regards market liberalisation, tariff adjustments, environmental upgrades and energy efficiency. Some progress was made notably to regulate para-fiscal charges. However, further efforts are needed. The labour market potential of the population at working age is not fully used; women, youth and recent graduates are not well integrated into the labour market and their employment levels are still below the country's potential. The large stock of unemployed does not benefit from an adequate support for reintegration into employment. Continuing emigration, including of people with particular skills, risks aggravating labour shortages in the future, given demographic developments. Social dialogue, in particular in the private sector, needs to be developed further.

Participants welcome that Serbia transmits the entire set of monthly MFI Interest Rate Statistics, has increased its effort in the area of national accounts and continues to improve the quality of data, including through the ongoing major revision of GDP. Further progress is expected regarding adherence to EDP methodology. Efforts on government finance statistics should be intensified and the data gaps in annual and quarterly national accounts should be addressed.

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

1. Maintain the identified medium-term budgetary objective close to balance. Contain overall spending on wages and pensions as a percentage of GDP. Implement the public sector wage system reform under the 2020 budget covering also security sector employees.

2. Increase government capital spending supporting long-term growth as a share of GDP in 2019 and over the medium term. To this aim, develop a single mechanism for prioritising and monitoring all investment regardless of the source of financing. Strengthen the fiscal responsibility framework by improving the system of fiscal rules, increasing its credibility and making it more binding and capable of anchoring fiscal policy.

3. Continue promoting the use of the local currency inter alia by fostering the development of interbank markets and secondary markets for government securities, and by considering additional ways to enhance long-term bank funding in dinar and hedging instruments. Implement the measures included in the recently adopted programme for resolving non-performing loans (NPLs) and the related action plan, including those aimed at further addressing NPLs in state-owned banks and government agencies. Finalise the privatisation and restructuring process of the remaining state-owned banks.

4. Use findings of the smart specialisation exercise to finalise a new industrial strategy. Adopt specific legislation on the alternative investment vehicles. Ensure that businesses and all social partners are consulted in time on all drafts of new legislation concerning their operations.

5. Gradually adjust electricity tariffs to reflect actual costs, including the costs of necessary maintenance and investments to upgrade the energy network and of meeting environmental standards and climate goals. Finalise unbundling of state-owned energy enterprises, in particular fully implement the long-delayed unbundling of Srbijagas and EMS and complete the functional unbundling of EPS in a compliant manner, as well as provide third-party access to gas infrastructure.

6. Significantly increase funding and the implementation of active labour market measures adjusted to the needs of the unemployed, in particular women, youth, including highly skilled persons. Adopt measures to incentivise the formalisation of labour in non-agricultural sectors. Reduce the high non-wage labour cost of jobs at the lower sections of the wage distribution.

The Republic of North Macedonia

The Republic of North Macedonia submitted its Economic Reform Programme 2019-2021 on 30 January 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been partially implemented.

The economy recovered in 2018 on the back of strong export performance and private consumption, while investment contracted. The ERP projects output growth to accelerate sharply, to 5% in 2021, driven by strong investment, with some positive contribution from the external balance. This expectation is very optimistic, given a number of significant downside risks to the growth outlook. The fiscal deficit is projected to increase this year, and to gradually decline in the following two years, mainly due to the impact of reforms of the pensions and the social assistance systems, and the move to progressive income taxation. The programme expects the general government debt-to-GDP ratio to rise further this year, driven by an increase in the primary balance, and to drop thereafter. However, public debt stabilisation remains a challenge given the large financing needs of public enterprises, which are, moreover, not included in the government fiscal data. Further consolidation efforts might be required to accelerate the pace of debt reduction. The government further enhanced transparency of public finances, in particular regarding the amount and the clearance of unpaid liabilities, but did not progress much on operationalising a medium-term budget framework nor on adopting fiscal rules.

Against the background of moderate inflation and substantial capital inflows in 2018, the central bank was able to meet with relative ease its intermediate target of a stable exchange rate to the euro to achieve its primary goal of price stability, allowing for some monetary accommodation.

The banking system is sound overall, showing favourable solvency, liquidity and profitability metrics. The reduced but still sizeable degree of currency substitution represents a financial stability risk. The timely implementation of the authorities' denarisation strategy could mitigate this risk. In addition, shoring-up the foreign currency liquidity of banks may constitute a provisional solution until positive effects from a timely implementation of the authorities' denarisation strategy will take hold. Still, considering the monetary policy strategy, banks have access to foreign currency liquidity from the central bank on the foreign exchange market. Moreover, private sector lending terms, in particular in the consumer loan segment, deserves ongoing monitoring by supervisors to counter potential risks at an early stage. Reviewing and improving the macroprudential framework may ensure a more effective supervision. The authorities' strategy to resolve non-performing loans (NPLs) should be duly operationalised with priority given to measures that are likely to have the most significant near-term impact. Despite progress with lowering the stock of NPLs on the balance sheets of banks in recent years, corresponding liabilities of borrowers have frequently not been fully restructured, also due to weaknesses in the debt resolution framework (mainly the preventive restructuring and insolvency legislation).

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) formalisation of the economy, (ii) integration of domestic companies in global value chains and (iii) addressing youth unemployment. Major structural obstacles are still affecting the business environment and preventing domestic companies from reaping productivity and competitiveness gains achievable by stronger integration in global value chains. Those obstacles include insufficiently transparent and inconsistent business inspection procedures, insufficient institutional capacity of civil courts for commercial dispute settlement, and a non-transparent and often unpredictable regulatory framework and system of para-fiscal charges.

In addition, a sizable informal sector creates unfair competition for the rest of the economy. Some progress has been made, notably the adoption of the strategy and corresponding action plan for formalisation of the informal economy. However, further efforts are needed in these areas. The labour market remains characterised by overall low activity and employment and high unemployment. Both youth unemployment and long-term unemployment are a prominent issue in underdeveloped regions affecting in particular low qualified and less represented ethnic groups. Young people experience poor and lengthy transitions from school to work reflecting weaknesses in the education system from early childcare and primary school onwards. Ensuring a high quality education for all and improving the educational infrastructure and curricula as well as the competences of the teaching staff is essential. The encouraging progress in the functioning of the social dialogue structures needs to be sustained, including on strengthening its legislative framework.

Participants welcome that the Republic of North Macedonia made important steps on EDP, government finance statistics and financial accounts in 2018 and that the provision of national and sector accounts is improving. Extra efforts are needed for quarterly government finance statistics, towards the full implementation of the European system of Accounts 2010.

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

1. Stabilise the debt ratio by moving towards a balanced primary budget while implementing the budgeted capital expenditure. Adhere to agreed consolidation measures, in particular the new pensions indexation formula. Implement legal and organisational measures to improve revenue collection.
2. Further increase the transparency of public finances by including public enterprises in the general government fiscal reporting framework where mandated by international statistical standards. Adopt the new organic budget law including fiscal rules and arrangements for an independent fiscal council.
3. Operationalise the adopted denarisation and non-performing loan resolution strategies, also by prioritising key areas of reform. Continue to closely monitor the emergence of potential financial stability risks related to the consumer loan segment, deploying appropriate micro- and macroprudential policy tools if needed. Legally clarify the national bank's mandate to set macroprudential policy and establish a framework for an effective co-operation among all agencies involved in macroprudential supervision.
4. Put in place and apply transparent and consistent procedures for business inspections implemented by inspectorates with clear mandates. Create a register of para-fiscal charges on central and local level. Reduce the time and costs of commercial disputes by strengthening the institutional capacity of civil courts.
5. Ensure the implementation of the Action Plan for Formalisation of the Informal Economy 2018-2020 in accordance with the timeline.
6. Implement the Youth Guarantee in the whole territory with an emphasis on underdeveloped regions by ensuring sufficient and qualified human resources of the Employment Agency, and the participation of relevant stakeholders. Strengthen the governance in the education sector in order to accelerate the modernisation of the education system at all levels through improving infrastructure, curricula and teachers' qualifications. Adopt and implement the new social protection legislation for improving the impact of social transfers on poverty reduction.

Albania

Albania submitted its Economic Reform Programme 2019-2021 on 30 January 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been partially implemented.

In a rather optimistic scenario, the Albanian ERP expects growth to accelerate from 4.3 % to 4.5 % over 2019-2021 helped by strong private consumption and investment. The latter would require further improvements of the investment climate and of public investment planning and implementation capacities. Despite considerable reduction in the last couple of years, a relatively high public debt level remains a key concern. The envisaged lowering of the debt ratio to below 60% of GDP by 2021 seems appropriate and within reach, even though it is largely driven by the expected acceleration of growth. Therefore, a growth-friendly frontloading of the fiscal consolidation process in 2019 could mitigate risks and support the ERP's debt target. Moreover, stronger fiscal rules in terms of timeline, enforcement, correction measures as well as medium-term consolidation plan setting out the steps to reach the fiscal rule's debt target of 45% of GDP would support fiscal stabilisation going forward. The number of VAT registered business and formal employees increased but overall informality remained high and tax collection remained below potential. The high degree of informality, undeclared work and tax evasion provide large scope for increasing the tax revenue share and support growth-friendly fiscal consolidation without raising tax rates.

Monetary policy has been accommodative with inflation remaining below the target in 2018.

The banking sector remains well capitalised and liquid, while the authorities made further progress in supervisory and regulatory convergence. Some consolidation took place during 2018 through two mergers, which brought the number of active banks down to 14. Asset quality continued to improve on account of a further decline in non-performing loans (NPLs), but significant structural and institutional obstacles to NPL resolution remain. The authorities have continued to implement the measures foreseen in the NPL action plan, including the set-up of an out-of-court restructuring scheme that is currently being tested in a pilot phase, but some important issues remain unresolved. As currency substitution is still high, indirect credit risk continues to pose a challenge to financial stability.

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy. The ambitious justice reform, which is currently under implementation, is expected to promote an effective and independent judicial system and contribute to the fight against corruption and informality.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) tapping renewable and energy saving potentials and fully opening the energy market and (ii) ensuring sustainable development of the tourism sector and (iii) improving the labour market relevance, quality and targeting of active employment policies, including upskilling of adults and VET. Still unclear land ownership and insufficient enforcement of property rights remain additional key challenges and the Government should ensure the implementation of last year's policy guidance. Much of Albania's growth potential is linked to sectors strongly depending on natural resources, like coastal tourism, agriculture hydropower and mining. However, the lack of strategic approach to the management of natural resources and the competing interests of those strategic sectors can impede the realisation of their growth potential. There has been some progress, notably in introducing renewable energy sources beyond hydropower. However, further efforts are needed. Active labour market policies remain insufficiently targeted, underfunded, limited in scope and unavailable in rural areas. Employment promotion programmes are not targeted and tailored enough to the needs of vulnerable categories of jobseekers. Social inclusion of vulnerable people requires ensuring the availability and capacity of social services at the local level across the country. The weak functioning of social dialogue in both the public and private sector indicates a need for sustained capacity building.

Participants welcome that Albania made visible progress concerning EDP notifications, annual government finance statistics and energy statistics. Significant gaps remain in national accounts, including quarterly national accounts and government finance statistics. Balance of payments, research and development, and labour market statistics also need attention.

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

1. Capitalise on the expected growth momentum to advance fiscal consolidation in 2019. Develop a medium-term consolidation plan to lower the debt ratio below the limit stipulated in the organic budget law. Develop a comprehensive medium-term revenue mobilisation strategy to effectively guide an increase in revenue, among others by addressing informality and tax evasion.

2. Ensure a systematic and complete recording of fiscal liabilities stemming from Public-Private Partnerships and of arrears at all government levels in the regular fiscal reports and the Macro-Fiscal Framework. Improve planning and execution of public investment. Increase spending on education and research in percentage of GDP in line with the government's policy objectives.

3. Explore potential measures for developing the market for currency derivatives that would enable economic agents to hedge themselves against exchange rate risk. Ensure the fully operational implementation of the remaining measures of the non-performing loan resolution strategy, also with a view to ensuring improved access to finance for corporates. Implement measures in the realm of the government in line with the Memorandum of Cooperation to increase the use of the national currency.

4. With a view to improving the investment climate, continue strengthening the justice system by implementing the justice reform and improve the provision of technical support services for micro, small and medium-sized enterprises, including through the development of a support network to help them upscale, invest, innovate, digitalise and export. To increase investments in tourism in particular, adopt the tourism strategy and start its implementation, focusing on sustainability through natural resource management. Provide for vocational education and training in line with the investment needs of SMEs and the tourism sector.

5. Ensure effective liberalisation of the energy market, with complete unbundling and a functioning power exchange. Finalise implementation of the law on renewable energy sources to ensure their integration into the market. Adopt the secondary legislation for the laws on energy efficiency and energy performance of buildings, including the setting up of the Energy Efficiency Fund.

6. Improve the targeting of active labour market policies and implement the prepared Vocational Education and Training reform package. Under the steer and with financial support from central government, establish capacities at the level of all local government units for assessing social care needs and preparing social care plans. Increase investment in early childhood education and care, especially for increasing enrolment of children from vulnerable families.

Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2019-2021 on 31 January 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been implemented to a limited extent.

The ERP expects economic activity to gain some momentum, with output growth accelerating from 3.5 % in 2019 to 3.8 % in 2021. This acceleration is projected to be driven by an inventory build-up and increased private consumption, thanks to rising employment and low inflation. Overall, the ERP's baseline projection reflects the failure of government policies to lift the country's growth potential through stronger public investment and through adequate steps to improve the business environment, which would foster stronger private investment. Key downside risks to the growth outlook are a sharper-than-expected deterioration in the external environment, and continuing delays in implementing reform measures in a difficult political context. The fiscal framework envisages increasing budgetary surpluses, largely based on containing spending, including investment. This approach does not sufficiently address the countries' key challenges. Furthermore, the presented fiscal scenario suffers from insufficient quantitative and explanatory support. A particular challenge is the lack of consistent and reliable country-wide data on general government finances.

Regarding financial stability, the banking system as a whole exhibits robust capital and liquidity buffers, but the legal framework should be strengthened further. Authorities have adopted a set of legislative reforms, but a final law on deposit insurance is still pending, which is a crucial element of the bank resolution framework. Approving the complete legal package entailing the establishment of a comprehensive bank resolution framework would buttress the legal underpinnings of the financial system. Ensuring sufficient coordination among bodies entrusted with resolution is essential. Notwithstanding improvements in asset quality, non-performing loans are still sizeable, which impacts on banks' profitability and constitutes an obstacle for credit extension. The dynamic rise of general-purpose loans poses a potential financial stability risk and warrants close monitoring.

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) enhancing the business environment through the creation of a single economic space, (ii) facilitation of starting a business, (iii) making the public sector more efficient, in particular improving the performance, transparency and accountability of state-owned enterprises, and (iv) improving labour market transitions. The overly complex and fragmented regulatory and institutional environment affects business in a major way, including through non-recognition of business registration across the country, numerous para-fiscal fees and charges emanating from overlapping administrations. Some progress was made notably to simplify business registration procedures through one stop shops and online registration and a mandatory electronic submission of VAT declarations was introduced. However, further progress is needed. The persistently low labour force participation attests to the limited capacity for transition of people to the labour market. Employment offices have low capacity to provide quality services, including targeted active labour market policies. High youth unemployment, even among university graduates, points to a lack of alignment between education and labour market needs. Disincentives to work, such as the high tax wedge on labour, need to be reduced. Consultations with the social partners on the design and implementation of economic, employment and social policies are weak.

Participants welcome that Bosnia and Herzegovina improved the completeness of annual national accounts and made an important step with the submission of an EDP notification in January 2019. Data for several statistical domains such as balance of payments, international investment position, regional accounts, labour force survey and foreign direct investment statistics are missing. While efforts should be pursued to improve the coverage and timeliness of all statistics, priority should be given to national accounts and government finance statistics, and putting in place adequate infrastructure for data transmissions to Eurostat and the ECB.

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

1. Strengthen the ERP's medium-term macro-fiscal planning framework through enhancing the analytical and forecasting capacities at all levels with a view to presenting a consistent and consolidated country-wide analysis and policy document. Enhance public-sector transparency by completing the recording of public sector employment, by addressing payment arrears and by publishing the trend and origins of public guarantees. In order to better support policy analysis, improve the provision of timely, exhaustive and in particular country-wide statistics on government finance, national accounts and labour market statistics, in particular by implementing a quarterly labour force survey.

2. Increase public investment, based on an investment strategy and actual implementation. Contain spending on public sector wages, based on a complete recording of public sector employment. Improve the targeting of social transfers, based on needs.

3. Safeguard the integrity of the currency board arrangement and the independence of the central bank in order to maintain monetary stability. Enhance the analytical and forecasting capacity of the central bank, and develop its toolkit by establishing a bank lending survey and by developing a macroprudential framework. Address remaining obstacles hindering the resolution of non-performing loans, and closely monitor the emergence of potential financial stability risks related to the consumer loan segment, deploying appropriate micro- and macroprudential policy tools if needed. Strengthen the bank resolution framework by adopting the law on deposit insurance.

4. As a step to improve governance and transparency, create publicly available registers of public enterprises providing up to date information on ownership, employees and comprehensive financial statements, including the companies' debt situation, and adopt and implement a credible and relevant country-wide Public Financial Management strategic framework with a performance based monitoring and reporting system. Advance restructuring and/or privatisation of public enterprises and improve their efficiency and corporate governance, including the two telecom companies in the Federation entity.

5. With a view to creating a single economic space, simplify and harmonise business registration, licensing and permit procedures between entities. Fully implement the law on electronic signature. With a view to reducing para-fiscal fees and charges, put legislation in place giving legal force to the developed registers of fees and charges.

6. Undertake a review of secondary and higher education enrolment policies in order to improve their links to the current and prospective needs of the domestic labour market. Reduce the tax wedge, especially for low-income workers, and disincentives to work in order to incentivise formal employment. Disburden public employment services from administrative duties related to health insurance for registered unemployed in order to free their capacities for more active support to jobseekers.

Kosovo*

Kosovo submitted its Economic Reform Programme 2019-2021 on 30 January 2019. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been partially implemented.

Economic growth continued in 2018, supported by public investment and private consumption. The ERP is on the optimistic side, forecasting an average annual GDP growth of 4.5 % in 2019-2021, above Kosovo's long-term average, on the back of a planned strong pick-up in public investment and robust private consumption. Despite the failure to implement the reclassification of war veteran pension beneficiaries, which has led to cost overruns, the 2018 budget deficit was lower than planned, largely due to an under-execution of capital spending. The fiscal strategy is frontloaded with the 2019 budget deficit projected to reach the upper limit of 2% of GDP fixed by the fiscal rule. The expected high revenue growth relies on the assumed growth acceleration and ambitious gains from tax compliance. The projected rise in expenditure is driven by a steep rise in current and capital spending, the latter due to the expected start of several infrastructure projects financed by privatisation revenues and international financial institutions (excluded from the deficit under the fiscal rule). Recurrent pressures from social groups for new transfers and entitlements threaten to crowd out productive investment. Relatively high and increasing public-sector salaries and non-targeted transfers carry fiscal costs and are detrimental to private-sector competitiveness and employment. Prioritisation, planning and coordination between policies are essential, while new initiatives should be properly evaluated and costed before adoption.

The banking sector is characterised by capitalisation and liquidity ratios that are well above the regulatory minima. Lending growth remained strong throughout 2018, in particular for consumer loans, spurred by lower interest rates, decreasing requirements for collateral, higher competition among commercial banks and good portfolio quality. The Credit Guarantee Fund has also improved overall access to finance for businesses. However, lending to SMEs continues to be held back by a number of legal and institutional factors such as lengthy court and contract enforcement procedures, high informality and the low availability of audited financial statements. The activity of non-bank financial institutions has gained traction recently, capturing a market segment not necessarily having access to bank lending, at much higher borrowing costs.

Across the region, further efforts are needed to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are (i) formalisation of the economy, (ii) tapping renewable and energy saving potentials and fully opening the energy market and (iii) increasing activity and employment levels. The informal economy distorts competition, and reduces public revenue collection and workers' rights, while the outdated energy production capacity, low energy efficiency and a not fully liberalised energy market and a tariff system that does not yet reflect real costs remain a key concern for businesses. Some progress has been made, notably with the establishment of the Energy Efficiency Fund in January 2019 and the adoption of the revised strategy and action plan to combat the informal economy. However, further efforts are needed in both areas. Despite steady economic growth, the labour market is not expanding. Activity and employment levels are very low, with marginal presence of women in the labour market. Education

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

does not match labour market needs, and the quality of teaching is low in most vocational schools. The provision of early childhood education and care is scarce. Social dialogue needs to be further developed, in particular in the private sector.

Participants take note that Kosovo achieved small improvements regarding annual national accounts and government finance statistics. However, major gaps exist in important domains such as national accounts, government finance statistics, harmonised index of consumer prices, and labour market statistics. Notably, Kosovo has not provided any EDP data so far. Efforts should continue towards a complete set of annual and quarterly national accounts and governmental finance data. More regular transmissions and better adherence to technical standards for data transmission are also encouraged.

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

1. Complete the war veteran certification and reclassification processes in order to decrease the costs of the war veteran pension scheme in line with the current legislation. Ensure, if necessary through secondary legislation to the Law on Public Salaries, that the 2020 budget complies with the existing fiscal rules, in particular with the wage bill rule. Improve the collection of tax revenues so that the ambitious revenue projections for 2019 are fully met.

2. Improve financial oversight and accountability of publicly owned enterprises. Strengthen institutional capacities at central and local government levels for multiannual investment planning and investment project management in order to improve the execution of capital spending. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultations with stakeholders, including the EU.

3. Continue improving the central bank's analytical toolkit, including by establishing an inflation expectations survey. Further identify and address the underlying legal and institutional factors hampering access to finance for SMEs. Closely monitor the emergence of potential financial stability risks related to the consumer loan segment, deploying appropriate micro- and macroprudential policy tools if needed. Continue to base decisions concerning the central bank's holdings of government securities on a transparent investment policy, and gradually reduce their level to avoid crowding out private sector activity on the secondary market.

4. Increase energy efficiency incentives for the private sector and households; adopt a plan that includes the gradual adjustment of energy tariffs reflecting expected increases in costs and mitigation measures for vulnerable consumers; improve the support schemes for renewable energy projects with the introduction of competitive bidding/auctions for renewables support.

5. Ensure the implementation of the new Strategy and Action Plan 2019-2023 to fight the informal economy in accordance with the prescribed timetable, integrating appropriate actions to address undeclared work.

6. Develop active measures for increasing female labour market participation and employment. Increase the provision of vocational education and training for professions in demand. Increase investments in education with particular focus on expanding early childhood education.