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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, 23 May 2017

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 2017 Economic Reform Programmes (ERPs) of the Western Balkans and Turkey, outline the medium-term macroeconomic and fiscal framework as well as structural reforms (affecting areas such as labour markets and education, energy, innovation and the business environment) to enhance competitiveness and long-term growth. Participants regretted that Serbia's ERP had been submitted with a significant delay. The programmes cover the period 2017-2019.

Participants took note of the Conclusions of the Presidency on 13 December 2016 which states that the General Affairs Council took note of the Commission's communication on the EU Enlargement Policy and the reports, which have a strengthened focus on economic governance. The dialogue on economic governance with the Western Balkans and Turkey is meant to prepare them for their future participation in the EU economic policy coordination. The dialogue reflects to some extent the European Semester process at EU level.

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 2016 policy guidance which had not yet been fully implemented remained valid and needed to be addressed by policymakers in the Western Balkans and Turkey.

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[1] Montenegro, Serbia, the former Yugoslav Republic of 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.

Montenegro

Montenegro submitted its Economic Reform Programme 2017-2019 on 31 January 2017. The authorities have partially implemented the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016.

The economy has entered into a robust investment cycle. However, the growth path is set to remain moderate due to the strong negative contribution of investment-related imports and the need for fiscal tightening. High import needs result in high and rising trade deficits. The already high public debt ratio is forecast to grow further. A sound medium-term fiscal consolidation strategy is needed to put public finances on a sustainable path, also in view of large refinancing needs in 2019 and 2020 that exacerbate vulnerabilities related to potential shifts in investors' sentiment.

Overall, the performance of the banking sector improved in the recent period. Nevertheless, the stock of non-performing loans (NPLs) remains sizeable and despite its steady decrease continues to weigh on banks’ profitability and constrains credit extension. At the same time, although the transfers of NPLs from banks to factoring companies have helped banks in cleaning up their balance sheets, this has not solved the problem of the high stock of NPLs among corporations. Domestic authorities are therefore encouraged to continue with policy actions aimed at fostering NPL resolution in order to reduce risks to financial stability and support the real economy.

Structural obstacles to growth and competitiveness include a lack of private sector dynamism and weak diversification of production, combined with a limited access to finance, a low employment rate related to an extensive informal sector, disincentives to the employment of women, non-targeted social benefits and the skills mismatch. Low enrolment in preschool education negatively affects outcomes at higher levels of education as well as labour market participation of women. The development of infrastructure, including in the area of telecommunications networks, is constrained by a difficult topography, resulting in high public investments and maintenance costs. It is important that such investments are based on sound cost-benefit analyses and complemented by regulatory reforms. While good progress was made on energy market opening, continued efforts are needed to ensure rail market opening through strengthening the capacity and independence of the rail regulatory and safety authorities. Further efforts are needed to build up high quality business support services and improve entrepreneurial skills and financial literacy of SMEs, as well as to create a level-playing field through strengthening the application of competition and state aid rules in line with the EU *acquis*. This will support ongoing efforts to diversify the industrial sector. Strengthening the rule of law, reducing the informal sector and tackling corruption remain important to further improve the business environment.

Participants welcome the further progress in the domain of energy statistics and the start of data transmission of regional accounts, and encourage further efforts to fill in the important remaining statistical gaps, especially for government deficit and debt statistics and government finance statistics as well as infra-annual statistics.

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

1. Fully implement the 2017 consolidation package, and take additional fiscal measures if necessary to achieve the envisaged budget savings of around 3% of GDP. Adopt a comprehensive medium-term fiscal strategy with concrete revenue and expenditure measures with sustainable effects in order to stabilise public debt and reduce debt-related vulnerabilities. Consider establishing an independent fiscal council.

2. Gradually reduce public spending on wages and pensions as a share of GDP. Ensure the availability of adequate financial resources for the implementation of new legislative measures. Strengthen tax revenues and review tax exemptions with a view to a further reduction of tax exemptions. Adopt measures in order to facilitate debt servicing by tapping the local debt markets, extending maturities, and advancing the privatisation agenda.

3. Continue efforts to foster NPL resolution by developing a comprehensive strategy to that end, including participation by all relevant stakeholders, with the aim of reducing credit risks in the banking sector and removing impediments to credit extension in the economy. Consider to include corporate debt restructuring and tackle other underlying structural obstacles of resolution as part of the strategy. Enhance prudential and banking resolution frameworks to the end of buttressing financial stability.

4. Harmonise national rules with Directive 2014/61 on cost reduction measures for the development of high-speed electronic communication networks. Ensure effective, efficient and independent rail regulatory and safety authorities to implement the full opening of the rail market.

5. Continue to strengthen financial and non-financial support services for SMEs. Adopt legislation to ensure the operational independence of the state aid authority.

6. Reform the law on social protection to ensure cost-effectiveness, better targeting of assistance and the reduction of disincentives for women to work. Carry out a review of active labour market policies with a view to improving their coverage and targeting the long-term unemployed, women and youth. Improve school-to-work transitions through work-based learning and promoting the appeal of vocational professions.

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Serbia

Serbia adopted the Economic Reform Programme 2017-2019 on 3 March 2017 and formally submitted it to the European Commission on 20 March 2017. The authorities have partially implemented the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016.

The economy expanded faster than expected in 2016. Growth is forecast to firm up slightly, increasingly underpinned by private consumption, while investment and exports are expected to remain robust. Fiscal consolidation continued to be very strong, outperforming all targets by a wide margin, and causing the public debt ratio to fall for the first time in many years. However, the pace of consolidation is planned to slow down significantly and the envisaged medium-term consolidation path might need to be more ambitious in light of remaining fiscal vulnerabilities. High-quality public investment should be prioritized in order to improve competitiveness and boost growth.

Monetary policy remained accommodative in 2016. The central bank lowered the inflation target as of January 2017 to 3% with a +/- 1.5 pp tolerance band, which is welcome. The economy remains sensitive to financial and commodity market shocks and is exposed to developments in the EU. Avoiding policy complacency is a key challenge as successful macroeconomic stabilisation has reduced the pressure for reforms.

Regarding financial stability, the strategy on non-performing loan (NPL) resolution has started to show positive results as the share of NPLs began to decline. The use of the euro is on a declining path, but remains high on both the credit and the deposit side and therefore authorities should continue their efforts to promote the use of the local currency by dis-incentivising both lending and saving in foreign currencies. Moreover, some state-owned banks remain that cumulatively account for losses and display a high NPL ratio.

Structural obstacles to growth and competitiveness include an excessive state influence in the economy and lead to below-potential dynamism. The energy and transport sectors continue to suffer from weak physical networks and inter-connections, inefficient markets and only partially restructured public utility companies. Access to broadband is well below the EU average. Private sector development remains hampered by a costly, unpredictable and non-transparent system of para-fiscal charges, difficult access to finance, red tape and a large informal economy. The level of state aid is relatively high and its attribution is not transparent. The system for prioritising and managing public capital expenditure remains inefficient. Recent labour market improvements have come along with an increase in informal employment. The reduction in unemployment is coupled with a substantial share of the working age population remaining inactive, limiting prospects for raising prosperity levels. Young people face particular difficulties in labour market access, fuelling their exodus and thus leading to brain drain. Participation in pre-school education remains low.

Participants welcome the submission of a fiscal notification for the first time in 2015 (covering 2011-2014), the further improvements in the domains of annual national accounts, short-term business statistics and international trade in goods statistics, and encourage further progress, in particular with respect to full ESA 2010 implementation, as well as to compilation of government finance statistics and government deficit and debt statistics.

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

1. Ensure a continuous reduction of the budget deficit in 2017 and over the medium term. Use any additional fiscal space to lower the deficit beyond the targets that are currently envisaged, while continuing to increase capital expenditure. Adopt a credible and binding system of fiscal rules, capable of anchoring consolidation efforts.

2. Support the fiscal scenario by reinvigorating reforms of the state owned enterprises and of the tax administration. Improve the composition of budget expenditure by further reducing public spending on wages and pensions as a share of GDP.

3. Implement the remaining measures of the NPL resolution strategy. Continue efforts to promote the use of the dinar, inter alia by maintaining a spread between reserve requirements in foreign currency and local currency also going forward. Finalise the reform and privatisation of the two large state-owned banks and find a solution for the remaining small state-owned banks. The monetary policy stance should be in line with achieving the new inflation target.

4. Gradually adjust electricity tariffs to reflect actual costs. Further improve payment collection and avoid future accumulation of arrears in the energy sector. Advance the announced restructuring of Srbijagas debt and the implementation of EPS's optimisation plan. Expand the scope of the Single Project Pipeline to cover all large investment projects regardless of their source of funding and establish clear links to the budgetary process.

5. Regulate the amount and number of para-fiscal charges at state level. Develop the regulatory framework for new financial instruments, and improve the access to finance. Put in place risk management systems in order to improve the functioning of the Tax Administration and to ensure better targeting and efficiency of inspections.

6. Increase labour market participation and reduce the high non-wage labour cost of jobs at the lower sections of the wage distribution in a fiscally neutral way. Target active labour market measures to vulnerable groups, including social assistance beneficiaries. Develop dual learning in vocational education and training in close cooperation with social partners.

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The former Yugoslav Republic of Macedonia

The former Yugoslav Republic of Macedonia submitted its Economic Reform Programme 2017-2019 on 31 January 2017. There has been limited implementation of the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016.

Economic growth slowed down, as a result of a decline in investment linked to effects from the enduring political crisis. However, household consumption and exports remained robust. The programme expects the economy to expand at a progressively faster rate each year, and acknowledges that these projections depend on resolving the political crisis and restoring investor confidence. After having resorted to two supplementary budgets in 2016, the fiscal deficit remained below the revised target, reflecting a severe cut in capital spending. While adhering to its targets for fiscal consolidation, the government has still not put forward any supporting measures. The level of public debt, albeit still moderate, rose further, and debt stabilisation remains a challenge in the face of rising financing needs of state-owned enterprises, and sustained primary fiscal deficits. The capacity to implement reforms remains severely hampered by the political stalemate.

While overall, the banking sector remains sound, the intensification of the political crisis in 2016 prompted a run on deposits, pressures on the peg and thus interrupted the deposit de-euroisation process. These developments were relatively short-lived, also thanks to the reaction of the central bank. Further policy action aimed at promoting the use of the denar in the banking system would be consistent with reducing tail risks to financial and macroeconomic stability. Furthermore, the ratio of non-performing loans (NPLs) in the banking sector, despite several measures undertaken by the central bank in recent years remained persistent (corrected for the effect of the mandatory write-offs in the last year), which (notwithstanding sound provisioning) calls for continuation of the ongoing activities and reinforced concerted actions by all relevant authorities targeting the underlying obstacles of NPL resolution.

Structural obstacles to growth and competitiveness include an excessive state influence in the economy, an underdeveloped private sector, an unpredictable regulatory environment without due stakeholder consultations, weak access to finance, informalities, declining human capital due to inefficiencies in the education system, skills mismatch, high unemployment (especially for youth and long-term) and low employment rate of women and people with low qualifications. In the absence of a Public finance management (PFM) reform programme, PFM continues to be negatively affected by insufficient transparency, inadequate planning, monitoring and investment prioritisation, as well as a weak procurement framework. More efforts should be made to ensure the National Investment Committee and the related single project pipeline are used as a comprehensive and effective system to set public investment priorities.

Participants welcome the transmission of government deficit and debt statistics for 2012 and 2013, the continuation of reporting national accounts main aggregates and regional accounts, and the improvements in the punctual transmission of quarterly national accounts. Participants stress the importance of making further efforts, in particular with respect to full ESA 2010 implementation and transmission in a timely manner, as well as the compilation and transmission of government deficit and debt statistics and government finance statistics.

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

1. Develop a proper fiscal consolidation strategy by defining and costing concrete revenue and expenditure measures on a multi-annual basis, whilst protecting growth-enhancing spending. Improve the efficiency and effectiveness of public spending by streamlining and better targeting transfer payments.

2. Improve budget planning capacity, in particular through the introduction of a medium-term expenditure framework. Enhance fiscal transparency by including information in the budget documentation on the composition of deficit financing; the budgetary impact of new policy initiatives; payment arrears; and spending and borrowing by state-owned enterprises. Adopt fiscal rules, as an ordinary budget law if their constitutional embedding proves difficult.

3. Continue efforts to further strengthen the use of the local currency and to further foster NPL resolution by developing a comprehensive strategy to these ends, with the participation of all relevant stakeholders. The monetary policy stance should remain consistent with the exchange rate peg, using available scope within this framework in line with safeguarding price stability.

4. Adopt a comprehensive and credible public finance management reform programme. Prioritise public investments against clear policy objectives. Increase the transparency on the selection criteria for investments and on their impact on economic growth and on the fiscal path.

5. Reduce the use of the urgency procedure for legislation and make full use of the National Electronic Registry of Regulations (ENER) to ensure proper and systematic consultation of the stakeholders, and reinforce the independence and the capacities of commercial courts.

6. Strengthen the outreach and coverage of active labour market policies towards the long-term unemployed, youth, and the low-skilled. Improve the qualifications of teachers and increase enrolment in pre-school education. Stimulate work-based learning in both initial and continuous vocational education and training.

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Albania

Albania submitted its Economic Reform Programme 2017-2019 on 31 January 2017. The authorities have partially implemented the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016.

Albania is experiencing a gradual economic upturn that is expected to continue in 2017-2019. Private consumption and investments are seen as the main growth drivers in the context of an improving labour market, record-low interest rates and significant FDI inflows. The growth projection is associated with downside risks stemming from persisting macroeconomic vulnerabilities and a renewed slide in oil prices. The central bank has extended an accommodative monetary policy stance while fiscal consolidation has reduced the budget deficit to a long-time low in 2016. Fiscal adjustment plans for the following three years have been scaled back in comparison to last year's programme, but are expected to be sufficient to continue reducing public debt as a share of GDP in line with the recently adopted fiscal rule.

Regarding financial stability, the ratio of non-performing loans (NPL) stayed high despite the partial implementation of the resolution strategy and the introduction of mandatory write-offs. Progress as regards de-euroisation on the lending side has been limited and the stock of foreign exchange deposits continued to grow. The non-bank financial sector exhibited fast growth reflecting inter alia the opening of a third investment fund in 2016.

Structural obstacles to growth and competitiveness include still unclear land ownership, poor access to finance, a high level of informality and corruption, an excessive regulatory burden and unpredictability in the judiciary system, which acts as a discouragement to both foreign and domestic investment. The lack of a comprehensive cadastre hinders the development of the agriculture sector, tourism, infrastructural improvements, access to finance, etc. Creating favourable conditions for private investment would facilitate much-needed investments in infrastructure. This would help to diversify energy supply. Market entry of private competitors should be encouraged through regulatory reforms. The completion of the liberalisation of the energy market is highly important. There is a need to further address structural unemployment and inactivity and to improve quality of education, as well as to increase the enrolment in pre-school education. Improvements have been achieved through the introduction of an e-building permit system, measures that tackle the informal economy and steps to boost the financial sustainability of the electricity sector.

Participants welcome the substantial progress towards complying with the annual and quarterly national accounts requirements with respect to completeness, the resumption of transmissions of annual government finance statistics, the transmission of regional accounts data, the further efforts in energy statistics and the start of partial transmissions of annual and quarterly international trade in services/balance of payments and foreign direct investment data. Participants encourage further efforts to fill in the gaps for infra-annual statistics, as well as for regular transmissions of government deficit and debt statistics and government finance statistics.

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

1. Continue pursuing fiscal adjustment with a view to meeting the indicated medium-term targets for reducing public debt as a share of GDP. Introduce further fiscal consolidation measures if debt reduction is at risk of falling short of target.

2. Persist with recent revenue mobilisation efforts, in particular by (i) strengthening tax administration further; (ii) broadening the tax base based on a review of tax expenditures; and (iii) introducing a valuation-based property tax.

3. Implement the remaining measures of the NPL resolution strategy. Implement the measures foreseen in the Memorandum of Cooperation to increase the use of the national currency effectively, including differentiated reserve requirements for lek and foreign exchange deposits. Strengthen the supervision of the non-bank financial sector by increasing the capacity of the financial supervisory authority. Return to a normalisation of monetary policy if inflation rates converge to the target in a sustained way.

4. Ensure the full unbundling of transmission and distribution activities in the electricity and gas sectors, and establish a power exchange. Adopt the legal provisions necessary to promote and monitor energy efficiency improvement measures in compliance with the Energy Community Treaty.

5. Continue the processes of clarifying the ownership of agricultural land and registering property, and put in place a functioning comprehensive cadastre and an e-cadastre by 2019.

6. Enhance the capacities of employment services and their provision of active labour market measures to the unemployed and inactive. By end 2017, outline concrete plans to address undeclared work. Intensify teacher training to improve quality of teaching and support curricular reform.

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Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2017-2019 on 31 January 2017. There has been limited implementation of the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016. The quality of the ERP section on structural reforms needs continued improvement by consolidation of the entities' contributions into a single coherent country-wide ERP with measures shared on a country-wide basis. The country-wide Reform Agenda should be used as an inspiration.

Economic activity is expected to accelerate slightly during the programme period. The main growth-supporting factors are projected to be private consumption and private and public investment. Employment is forecast to benefit from stronger output growth and supportive measures, while unemployment is seen to decline but will still remain high. On the back of stronger domestic demand, external balances are expected to deteriorate somewhat. The programme expects the general government fiscal balance to register surpluses in 2018-19, based on moderately increasing revenues and a freeze in spending. However, spending on public investment and education is planned to drop faster than most other expenditure items, which is not conducive to growth. Weaknesses in fiscal governance include limited administrative capacities for medium-term analysis and planning.

On the financial stability side, sizeable levels of non-performing loans (NPLs) impact banks profitability and constitute an obstacle for credit extension for some banks. To this end, authorities are in the process of adopting a set of legislative reforms which should facilitate the removal of NPLs from banks’ balance sheets. Approving new banking laws that entail the establishment of a comprehensive bank resolution framework would buttress the legal underpinnings of the financial system, ensuring the coordination among bodies entrusted with the resolution is sufficiently strengthened.

Structural obstacles to growth and competitiveness include the absence of a common economic space including non-recognition of business registration across the country. There is also a lack of country-wide strategies in important sectors such as energy and public finance management. Widespread informalities and corruption affect the business environment. While the law on electronic signature in Bosnia and Herzegovina has been in force since 2006, the institutional framework necessary for the secure and successful implementation of the law is still not in place. Achieving stronger and sustainable economic growth will require a more efficient public sector and a more dynamic private sector. Labour market performance is hampered by weak provision of employment services and high tax burden on labour. In the area of education, the widespread skills mismatch and low participation in preschool education remain among the key issues.

In light of this assessment, and also taking into account the Reform Agenda, Participants hereby invite Bosnia and Herzegovina to:

1. Enhance the growth-friendliness of public finances; in particular, create fiscal space for public investment by containing spending on public consumption and improving the targeting of social spending. Take steps to reduce public sector payment arrears, including social security contributions.

2. Improve the provision of timely and exhaustive statistics, in particular government finance, national accounts and labour market statistics. Strengthen capacities for consolidated macro-fiscal analysis and planning at country level by enhancing coordination between the various stakeholders and apply the current medium-term fiscal planning instrument in a policy-oriented way. Strengthen the country-wide public debt management capacities at all levels, in particular the cooperation and flow of adequate and full information from all data providers.

3. Follow up on ongoing legislative changes and develop a comprehensive strategy fostering the resolution of NPLs to address the fragilities of bank balance sheets and thus help remove supply-side bottlenecks to credit extension. Strengthen the bank resolution framework by ensuring sufficient coordination among the bodies entrusted with resolution. Establish a bank lending and inflation expectations survey in order to better gauge underlying credit and price dynamics.

4. Adopt a country-wide energy sector reform strategy and a legal framework in compliance with the Energy Community Treaty.

5. Simplify, harmonise and ensure mutual recognition of business registration procedures between entities, including concessions, licensing and allowing branch office registration across entities. Introduce e-payment services on taxation and fully implement the law on electronic signature.

6. Strengthen the employment services to better assist job seekers, in particular youth, women and long-term unemployed. Reduce the tax wedge and reinforce delineation of employment and social policy measures. Increase enrolment in pre-school education. Address skills mismatches by increasing participation in vocational and higher education programmes relevant for labour market needs.

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Kosovo [*]

Kosovo submitted its Economic Reform Programme 2017-2019 on 27 January 2017. The authorities have partially implemented the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016.

Economic growth continued in 2016, supported by domestic demand. Economic activity is forecast to remain resilient with growth rates close to Kosovo's long-term average on the back of strong household consumption and an expected pick-up in public investment. Despite the higher-than-expected cost of the recently introduced war veteran pension scheme, public finances do not give rise to immediate concerns in the context of low, but increasing, public debt. However, the rise in current expenditure needs to be contained, notably through reinforcing the functioning of fiscal rules. The budget deficit was lower than planned in 2016. The 2017 budget contains realistic revenue projections, but capital spending targets seem overly ambitious, in particular as administrative capacities to prepare and execute investment projects remain limited. Despite some delays, structural reforms have advanced. However, the economy still faces a number of challenges and is exposed to political and other domestic risks.

Near-term challenges to financial stability stemming from the banking system appear contained, with the sector characterised by high capitalisation and liquidity buffers. Credit growth gathered further pace in 2016, although financial intermediation remains low. Bank lending continues to be held back by a number of legal and institutional factors, also mirrored in the still high costs of borrowing. The amendments to the Law on Enforcement, as well as the broadened scope and the increase in the number of Private Enforcement Agents are welcome actions to reduce supply-side bottlenecks to lending.

Structural obstacles to growth and competitiveness include an unreliable energy supply, widespread informalities in the economy and the weak rule of law. Some measures adopted in the customs and tax administration and the introduction of e-procurement are welcome steps to address the large informal economy. First steps have also been taken towards a comprehensive strategy for the energy sector. The very low labour market participation combined with a steady labour force increase call for robust action in employment and education policies at all levels. It is of utmost importance to develop a comprehensive approach fostering labour market integration of young people and increase targeted labour market measures.

[*] 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.

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

1. Enhance the institutional capacities and ensure appropriate staffing at the Ministry of Finance in order to improve macro-fiscal planning, forecasting and fiscal impact assessments. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultations with stakeholders, including the EU.

2. Strengthen institutional capacities at central and local government levels for public procurement, multiannual investment planning, and investment project preparation and management in order to improve the execution of capital spending. Take steps towards introducing targeting and means-testing to all war veteran programmes in order to further contain current expenditure.

3. Further address the underlying legal and institutional factors hampering access to finance for corporates to improve banks' incentives to lend to enhance financial intermediation in the economy. Continue improving the central bank's analytical toolkit (including through the establishment of a reliable measure of private sector inflation expectations in order to better gauge underlying price dynamics), and develop a liquidation and bank resolution framework to strengthen the overall resilience of the banking sector.

4. Establish a financing mechanism to support energy efficiency measures and adopt energy efficiency incentives to the private sector and households. Complete the deregulation of energy generation prices, gradually deregulate electricity supply prices and gradually adjust energy tariffs to reflect actual costs.

5. Complete the risk assessments focusing on the sectors and branches most vulnerable to informalities and identify and apply appropriate corrective measures.

6. Adopt an action plan for tackling youth unemployment, based on a sound assessment of the challenges. Finalise the operationalization of the Employment Agency. Target reforms in vocational education and training and higher education on business sectors with labour demand and job creation potential. Increase enrolment in pre-school education.

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Turkey

Turkey submitted its Economic Reform Programme 2017-2019 on 7 February 2017. There has been limited implementation of the targeted policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2016. The ERP projections are not based on the revised national accounts and therefore provide an incomplete picture of the macro-economic and fiscal situation. The quality of the ERP section on structural reforms needs continued improvement with a diagnostic identifying the challenges to competitiveness and inclusive growth and clearly delineated reform measures.

The Turkish economy registered high growth till 2015 but lost momentum going into 2016 as a result of domestic and external developments had affected negatively business environment. Economic growth is expected to increase in the second half of 2017 as monetary conditions start to improve. Inflation has increased from high single-digits registered over the past five years to low double-digits in February 2017 in large part owing to the lira's depreciation and entrenched expectations of high inflation. Missing the inflation target again by a wide margin negatively affects the credibility of the monetary policy framework. The government has provided sizeable stimulus to the economy and significantly increased its expenditures in the course of 2016. Net trade, as a consequence of the lira's depreciation, and public expenditures will support growth in 2017. The general government expects to improve its budget balance in 2017 compared to 2016, which seems difficult to achieve. Financing of the sizeable current account deficit continues to rely on volatile types of capital flows, implying significant risks in times of high economic and political uncertainty.

Turkey’s banking sector seems overall stable in light of comfortable capital buffers as well as liquidity coverage ratios well above legal limits, indicating some capacity to absorb a possible deterioration in asset performance. While there are sufficient buffers to absorb the short-term weakness of the economy, the sharp lira depreciation and the large net open foreign exchange position of the non-financial corporate sector are potential risks on the back of the economic slowdown.

Turkey is confronted with a number of challenges to growth and competitiveness which should be stimulated by structural reforms that support demand, increase productivity, and lower imbalances. Spending on research and development is on an increasing trend but remains low, and the cooperation between research institutions and economic operators could be improved. There is a low capacity of companies, notably SMEs, to adopt and implement innovative production processes. The steady increase of the work force requires a high level of job creation. Low skills levels of the workforce and some labour market rigidities impede productivity increase and job creation. Informal employment remains high. Low participation in pre-school education persists. Women’s participation is increasing but still comparatively low.

Participants welcome the revision of national accounts to be in line with ESA 2010, however the transmission of the detailed sources and methods is necessary. Participants also encourage the regular transmission of government deficit and debt statistics.

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

1. Lower external imbalances in light of high external funding needs constituting a substantial risk for the Turkish economy. Promote domestic savings by incentivising higher private sector savings and by following a sufficiently tight fiscal stance over the medium term in light of external vulnerabilities built up over the years. The adoption of a fiscal rule would enhance budget transparency, provide an important fiscal anchor and enhance credibility.

2. Update the macro-fiscal scenario taking into account the revised national accounting methodology as well as the budgetary impact of new policy initiatives, such as the Turkish sovereign wealth fund and the new credit guarantee scheme.

3. Intensify efforts to sustainably achieve price stability. Better anchor inflation expectations by pursuing a more credible and tighter monetary policy stance as soon as GDP growth rebounds and by clearly communicating this to the public. Furthermore, the central bank should not step backwards in terms of its self-imposed objective to simplify the monetary policy framework.

4. Strengthen the rule of law and the judiciary with a view to improving the business environment and investors' confidence.

5. Update the strategy in support of research and development; this should target an increase in total spending on research and development and include financial and legislative initiatives to support the capacity of companies, notably SMEs, to adopt and implement innovative production processes.

6. Focus skills development on sectors with growth potential and skills needs, and expand provision of relevant vocational training. Reform the severance pay system in order to reduce labour market rigidity. Reduce informal employment through, *inter alia*, increase of inspection capacities, with particular focus on non-agricultural employment. Improve teacher training and improve the performance of the education system towards international best practices. Promote the professional education and labour participation of women.

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As regards statistics, Participants underline the importance of reliable, up-to-date data, in line with the EU acquis, and therefore welcome the 2017 Progress Report on the Action Plan on Economic, Monetary and Financial Statistics for Candidate Countries. They took note that all the Candidate Countries made progress in fulfilling the Action Plan requirements, but noted that additional efforts in some statistical areas are still needed to achieve a full compliance with the Action Plan requirements.

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 make further progress with respect to their macroeconomic, budgetary and structural policies. Participants also noted the links between the progress on rule of law/fundamental freedoms and the improvement in economic governance and the judiciary system. The dialogue will continue in 2018, including on the implementation of these conclusions.