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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

KOSOVO*
(2023-2025)

COMMISSION ASSESSMENT

**** 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.***

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1. EXECUTIVE SUMMARY

Following a slowdown in economic activity in 2022, Kosovo's economic reform programme (ERP) expects economic growth to pick up, mainly on the back of a robust rebound in private and public investment. Annual output growth eased markedly to 3.5% in 2022, primarily due to a strong contraction of investment and a deceleration in household consumption growth. The ERP baseline scenario projects an annual average GDP growth of 6.1% in 2023-2025, which is above the historical trend and appears to be optimistic. In particular, the strong rebound in investment, a key growth driver in the ERP scenario, is likely to face constraints. These constraints are related to weak planning and insufficient implementation capacity for public investments and an uncertain economic environment for private investments. Major downside risks to this outlook come from higher-than-expected energy and food prices resulting from Russia's war of aggression against Ukraine and the related energy crisis. These could also lead to less dynamic trade developments with Kosovo's main EU (and non-EU) trading partners. Further risks stem from tighter financing conditions and lower-than-expected financial inflows from the diaspora.

After 2 years of substantial fiscal consolidation, the ERP expects a strong fiscal impulse in 2023 while ensuring compliance with the deficit rule in 2023-2025. Supported by high revenue growth and a significant under-execution of public capital spending, the headline budget deficit fell to 0.5% of GDP in 2022, continuing the fiscal consolidation that started in 2021. The 2023 budget plan expects the headline budget deficit to rise to 3.4% of GDP, implying a strong fiscal stimulus mainly through an increase in public spending driven by investment and higher wages. However, the deficit (according to the fiscal rule definition) would not exceed the prescribed ceiling of 2% of GDP. In the medium term, the ERP expects the deficit to fall again thanks to contained current spending. Immediate fiscal risks, some of them described in the programme, stem from lower-than-expected revenue and pressure to roll out new social benefits.

The main challenges facing Kosovo are the following.

- **The expected compliance with the deficit rule will serve as an anchor for fiscal policy but necessitates reforms to support public finances.** Given the high degree of uncertainty amid Russia's war of aggression against Ukraine and the related energy crisis, it seems appropriate to use the fiscal space in the 2023 budget to continue providing temporary and well-targeted policy support to vulnerable households and firms as needed. To comply with the 2% deficit ceiling in 2023-2025, policies must be implemented that strengthen the revenue base and contain current spending. A review of existing tax exemptions and preferential tax rates would help mobilise revenue. Current spending would benefit from a review and streamlining of social benefits, including war veteran pensions, and a proper assessment of the fiscal impact of new social initiatives.
- **The significant increase planned in public investment requires comprehensive reforms to improve project planning and implementation.** Kosovo has made little progress in strengthening public investment management, and steps should be taken to improve the execution of capital spending by implementing the recommendations of the International Monetary Fund (IMF) Public Investment Management Assessment. The fiscal risks related to publicly owned enterprises (POEs) should be mitigated by improving their financial oversight and accountability. This can be advanced by approving and publishing annual performance reports. Related investment decisions should be properly assessed, incorporated into budgetary planning and contribute to the overall investment strategy.

- **The unreliable and undiversified supply of energy is inadequate to meet rapidly growing demand and is one of the main constraints on Kosovo's competitiveness, acting as a brake on productivity and exacerbating the energy crisis.** The lack of energy security gives rise to significant costs for businesses and represents a major obstacle to attracting high-quality foreign direct investment (FDI). To develop a secure and sustainable energy supply, Kosovo needs to find attractive alternatives to polluting sources of energy and invest in energy efficiency measures. In March 2023, Kosovo approved a new national energy strategy. Preparations have been made to establish a competitive auction-based system for renewables, but the legislative and regulatory work has yet to be finalised the first auction is delayed by at least one year. Progress in regional integration of electricity markets could support the financial stability of the Kosovo transmission system operator (KOSTT).
- **The digitalisation of the economy is advancing step by step.** Kosovo has a small but rapidly growing ICT sector, particularly in the export of software development, smart phone application development and web design. More needs to be done to train skilled workers in this sector where demand for employees outstrips supply. The Economic and Investment Plan for the Western Balkans will continue supporting investment in digital infrastructure to deploy ultra-fast and secure broadband to ensure universal access. Kosovo needs to continue developing the legal framework and infrastructure needed to stimulate e-commerce, increase the adoption of e-commerce practices among SMEs and make international electronic payments possible.
- **Further reforms are needed to improve the quality and relevance of the education system to increase employment and reduce skills mismatches.** The labour market is dominated by agriculture, the public sector and micro, small and medium companies. Many young people, particularly young women, struggle to find their first professional experience. The government has not made the necessary reforms to the education system so that it meets the needs of the labour market. Indeed, the education system has not made the necessary reforms to adapt to the needs of the labour market. The informal economy and clientelism are still an alternative to working or seeking work ('inactivity') and emigration. The authorities have initiated a number of major structural reforms to address these issues. These include facilitating access to pre-primary schools, including in rural areas, introducing dual education, reforming the social protection system, and modernising employment services. In line with the Western Balkans Declaration on ensuring sustainable labour market integration of young people[1], the authorities are committed to implementing the Youth Guarantee.
- **Persistent, widespread informality and a weak business environment remain a key structural challenge for Kosovo's economy. The** informal economy limits the fiscal space for public spending in priority areas, deters the development of the private sector and prevents a significant part of the workforce from accessing proper levels of social protection and training. There has been good progress in recent years with work on formalisation and compliance helping to increase tax revenues. However, there is still room for improvement. Preparations have begun to improve the business environment by simplifying and digitalising licences and permits although more effort is needed. Kosovo has yet to attract significant foreign direct investment in the productive economy. Although the government has initiated plans to address this, strong political support,

(1) [Bolstering the resilience of youth in the Western Balkans | ETF (europa.eu)]

effective implementation and close monitoring are required to achieve the desired outcomes.

- **The Common Regional Market and the Economic and Investment Plan for the Western Balkans are important tools to leverage sustainable growth and competitiveness**. The Common Regional Market will help integrate Kosovo into regional and European value chains and help increase the attractiveness of the economy for foreign direct investment in tradeable sectors. Further connectivity with neighbouring countries in transport and energy will strengthen access to, and integration into, the regional market. The creation of a regional digital space and labour markets that are more integrated with neighbouring economies will offer new opportunities for Kosovo's young people, which is important given the high rate of youth unemployment. Kosovo's regional integration faces an additional challenge due to the political issues related to non-recognition.

Kosovo has partially implemented the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2022. Strong public revenue and a significant under-execution of public investment substantially improved the budget balance. Compliance with the fiscal rule's deficit ceiling of 2% of GDP is expected in 2023. Some of the measures to mitigate the impact of high inflation could have been better targeted. There has been no progress in reviewing social security schemes and war veteran pensions. The new law on public-sector salaries, combined with a suitable value of the wage coefficient set by the government, ensures that the public wage bill does not exceed its legal ceiling. Tax revenue grew strongly on the back of high inflation and a reduction in the informal economy, but there was little progress on reviewing tax exemptions. The financial oversight of POEs has improved but work to set up a fiscal oversight body has not advanced. Investment management also remains a major weakness. The government recently approved a 10- year national energy strategy but has yet to draft a National Energy and Climate Plan. Some energy efficiency measures have been implemented and preparations have been made to launch competitive auctions for renewable energy projects. However, little has been achieved in the area of market liberalisation. The new action plan to combat the informal economy was adopted, and the tax authorities have had some recent success in tackling this problem. However, there was no progress on price transparency for real estate transactions, and many measures in the existing action plan are yet to be implemented. The youth guarantee implementation plan has been finalised, but more human resources in the public employment service are needed to deal with the increased number of registered unemployed people.

The ERP sets out reform plans that are broadly in line with the key challenges and priorities identified by the Commission. It reflects the government's intention to support the economic recovery in 2022 and strengthen the sustainability of public finances in the medium term. It includes measures to improve the business environment, attract investment and reduce the informal economy. The ERP also partially addresses energy access challenges and the capacity of the education system to respond to labour market needs. Although the proposed measures in the ERP are aligned with the main structural challenges and much work has been done to prepare reforms, their implementation has so far been delayed.

2. ECONOMIC OUTLOOK AND RISKS

Kosovo's economic rebound moderated significantly in 2022 due to the impact of Russia's war of aggression against Ukraine on energy prices and inflation, as well as a decline in investments and remittances. Real GDP growth eased to 3.5% in 2022[2], primarily due to a strong decline in gross fixed capital formation, mainly driven by shrinking public investment and tighter financing conditions, and a deceleration in household consumption growth due to an inflation-induced drop in real disposable incomes. Economic activity was propelled by temporary government support measures (3.5% of GDP in 2022) to mitigate the impact of the energy crisis. Moreover, a strong increase in exports of goods and services together with a sharp slowdown in real imports growth resulted in a positive contribution of net exports to GDP growth. At the same time, diaspora-related inflows provided less support to growth; the share of net inflows of remittances in GDP dropped moderately.

The ERP's baseline scenario projects a robust acceleration of economic activity with GDP growth to go above the historical trend in 2023-2025. Real GDP is set to increase by 5.5% in 2023 and by 6.1% and 6.7% in 2024 and 2025, respectively. This is well above pre-pandemic growth rates, which averaged almost 5% in 2015-2019. Growth acceleration is expected to be driven by a surge in public investment in 2023 (+10.4% year-on-year). Public investment look set to benefit from: (i) implementing planned projects; (ii) the easing of some bottlenecks, including the Procurement Review Body board becoming operational again, and (iii) implementing the public works support law, which compensates contractors for higher input prices. Private investment is also expected to increase due to government support, less uncertainty and the private sector's improving balance sheets. The ERP projects annual investment growth to remain high at around 8.5% in 2024-2025. Negatively affected by inflation but supported by higher bank lending and social transfers, private consumption is set to increase marginally by 0.2% in 2023, and to accelerate to around 5% on average in 2024-2025, although the key reasons for this are not described in the programme. Public consumption is projected to rebound strongly by 8.6% in 2023 and increase marginally after that. This is due to a significant rise in expenditure on goods and services, as well as on public-sector salaries following the new wage law coming into effect. Real exports are set to increase by 4.7% in 2023 and continue growing by around 7% on average in 2024-2025. Imports are expected to rise marginally by 0.8% in 2023 although this appears to contradict the projected strong investment recovery. As a result, the ERP projects net exports to still provide a positive contribution (1.4 pps) to GDP growth in 2023, albeit much lower than in 2022. In 2024-2025, accelerating import growth (up to 4.7% on average) will cause net exports to negatively contribute to GDP growth. The programme expects the output gap to remain slightly negative in 2023 and to turn positive after that as real growth is projected to exceed potential growth.

Amid high levels of economic uncertainty, the ERP's baseline scenario looks overly optimistic. GDP growth rates for 2023 and 2024 have been markedly revised downward from the previous year. However, the rates still appear rather optimistic and well above the 3.8% average annual expansion projected by the IMF. In particular, the rebound in investments, a key growth driver in the ERP scenario, is likely to face constraints caused by weak planning and insufficient implementation capacity for public investments and an uncertain economic

[2] Macroeconomic and fiscal estimates and forecasts covering the period 2022-25 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2022 have been taken from the relevant national sources (national statistical office, ministry of finance, central bank).

environment for private investments. The ERP itself notes that macro-fiscal risks have increased significantly due to the economic fallout from Russia's war of aggression against Ukraine and the related energy crisis. Further rises in energy and food prices, a continued tightening of the monetary policy stance and the associated economic slowdown in the euro area will likely affect Kosovo by dampening demand for its exports and may cause a further slowdown in inflows of remittances. A substantial domestic risk stems from high import costs and outdated power generation capacity, which may result in more power cuts and higher energy subsidies. The ERP's 'low growth' scenario results in an average annual growth rate of around 3% in 2023-2025, which currently appears more realistic than the baseline. The scenario's main assumptions are the under-execution of public investment, lower foreign demand, a slowdown in remittances and higher import prices.

Table 1

Kosovo - Macroeconomic developments

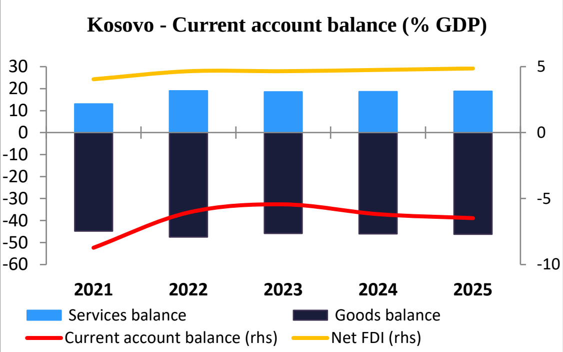
	2021	2022	2023	2024	2025
Real GDP (% change)	10.7	4.1	5.5	6.1	6.7
Contributions:					
- Final domestic demand	11.3	-3.2	4.5	6.3	7.4
- Change in inventories	-0.3	-1.1	-0.4	-0.1	-0.1
- External balance of goods and services	-0.3	8.3	1.4	-0.1	-0.7
Employment (% change)	10.4	:	:	:	
Unemployment rate (%)	20.7	:	:	:	
GDP deflator (% change)	6.1	8.1	4.2	1.6	0.8
CPI inflation (%)	3.3	11.6	4.3	2.2	1.2
Current account balance (% of GDP)	-8.7	-6.1	-5.4	-6.2	-6.5
General government balance (% of GDP)	-1.2	-0.5	-3.4	-2.2	-1.1
Government gross debt (% of GDP)	21.5	19.8	22.6	23.0	23.8

Sources: Economic Reform Programme (ERP) 2023.

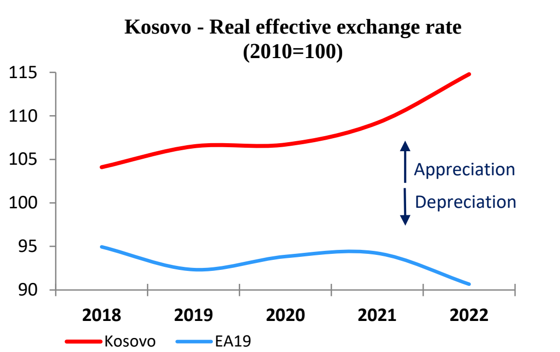
After peaking in 2022, average inflation is expected to decline in 2023-2025. After some slowdown in the last 3 months of the year, consumer price inflation averaged 11.6% in 2022, notably higher than the 3.3% rate registered in 2021. The main causes were rising food, energy and transport prices. Inflation inched up to 12.1% in January 2023, before slowing to 10.5% in February. The ERP expects average annual inflation to fall to 4.3% in 2023 and further to 2.2% and 1.2% in 2024 and 2025, respectively, on the back of the high base in 2022 and gradually decelerating commodity prices in international markets. The ERP's inflation projection appears rather benign, compared with the IMF forecast of an annual inflation rate of about 5% in 2023. The programme rightly acknowledges the external risk of a further escalation of the war in Ukraine. This would leave Kosovo exposed to high inflationary pressures caused by higher import prices of food, agricultural and energy products, the latter potentially exacerbated by shortfalls in domestic electricity production. Inflation risks also come from demand pressures from higher public-sector salaries, included in the 2023 budget, and a potential increase in social benefits.

The current account deficit widened significantly in 2022, but the ERP projects it to decrease to around 6% of GDP over the programme period. The strong energy-balance-driven increase in the merchandise trade deficit outweighed the continued rebound of services exports. This resulted in the current account deficit widening to 10.5% of GDP in 2022 from 8.7% of GDP in 2021. The strong rebound of services exports, mainly driven by diaspora tourism from Western Europe, fuelled a 2.4 pps increase in the services surplus to 15.4% of GDP. Exports of goods, which are much lower than exports of services, rely on a narrow product base, including base metals, various manufactured articles, and plastic, rubber and mineral products. These exports shot up by 22.8% year-on-year despite the high electricity prices in 2022 affecting the price of base metals, the main export product. Imports of goods also rose quickly (by 21.2%) mainly due to higher energy imports. This resulted in the traditionally high merchandise trade deficit widening from 44.8% of GDP in 2021 to 47.9% in 2022. The overall trade deficit increased to 32.5% of GDP in 2022 from 31.8% in 2021, and the ERP projects it at around 27% in 2023-2025. The primary income surplus fell to 1% of GDP from 1.9% in 2021. Remittances also decreased to 13.7% of GDP in 2022 from 14.5% in 2021, and they are forecast to follow historical trends in 2023-2025 with an annual average growth of 5%. Large errors and omissions (2.7% of GDP) may reflect unrecorded services exports and remittances, thereby the actual current account deficit could be smaller than the official estimates. The current account deficit is expected to narrow significantly in 2023 (to 5.4% of GDP). This appears optimistic given the 2022 reading, even if lower commodity prices, an overall stable trade surplus in services and a sustained growth of remittances are assumed. A gradual increase in the current account deficit in 2024-2025 (reaching 6.5% of GDP in 2025) appears in line with higher import growth reflecting rising domestic demand and higher investment.

External competitiveness and current account



Source: Economic Reform Programme (ERP) 2023.



Source: Economic Reform Programme (ERP) 2023 and ECB.

Net foreign direct investment, mainly driven by inflows from the diaspora into real estate, remains the main financing source of the current account deficit. Net foreign direct investment inflows grew strongly to 6.7% of GDP in 2022, covering 64% of the current account deficit. The bulk was directed to non-tradeable activities, with real estate and financial and insurance services accounting for 67% and 7% of all foreign direct investment inflows respectively, doing little to improve export capacity. The ERP projects that net foreign direct investment inflows will increase from EUR 0.5 billion in 2023 to about EUR 0.6 billion in 2025. These inflows are therefore expected to stabilise at around 4.8% of GDP, which is not enough to fully cover the current account deficit. Kosovo’s net international investment position deteriorated tod-18% of GDP in 2022, compared -11.5% in 2021. Around two thirds of gross liabilities consist of foreign direct investment, which is typically considered a more stable source of financing, limiting external vulnerabilities. Reserve assets are falling, from 2.5 months of imports in 2021 to 2.2 in 2022. They are expected to fall further to around 2 months in 2023-2025.

Table 2

Kosovo - Financial sector indicators

	2018	2019	2020	2021	2022
Total assets of the banking system (EUR million)	4 186	4 761	5 365	5 960	6 762
Foreign ownership of banking system (%)	86.8	86.7	86.5	85.5	84.9
Credit growth (aop)	10.9	10.0	7.1	15.5	16.1
Deposit growth (aop)	8.7	16.2	11.6	12.4	13.3
Loan-to-deposit ratio (eop)	81.9	77.6	74.5	76.5	78.3
Financial soundness indicators (%, eop)					
- non-performing loans to total loans	2.7	2.0	2.7	2.1	2.0
- regulatory capital to risk-weighted assets	17.0	15.9	16.5	15.3	14.8
- liquid assets to total assets	38.5	38.7	39.8	37.4	36.5
- return on equity	20.4	18.9	14.0	17.6	20.6
- forex loans to total loans	14.7	14.2	7.2	5.5	14.8

Source: National Central Bank.

The predominantly foreign-owned banking sector remained resilient and continued to expand. Annual credit growth accelerated slightly to 16.1% in 2022, largely on the back of businesses needing more credit to cover higher input costs. However, new loans to households, mostly for spending purposes, only grew slightly. There are non-negligible risks from a weaker economic outlook, higher commodity prices, and lower-than-projected remittances. These could weaken deposit growth, tighten liquidity, reduce demand and affect asset quality; therefore, the banking sector should be monitored closely. Moreover, as new mortgage lending to households has been growing relatively strongly, it appears appropriate to strengthen surveillance of the housing market, including by compiling residential sector statistics using bank loan data. The growth of deposits picked up from 12.4% in 2021 to 13.3% in 2022. Financial soundness indicators remained satisfactory, e.g. the loan-to-deposit ratio and non-performing loan (NPL) ratio ([3]) stood at 78.3% and 2%, respectively. Bank profitability has improved in nominal terms with the average return-on-equity ratio reaching 20.6% in 2022, up from 17.6% in 2021. The ERP does not provide quantified forecasts for the financial sector. However, the underlying assumption, which appears plausible, is that the NPL ratio will grow to 3.5% in 2023. Furthermore, the pressure on the liquidity of the largely foreign-owned banking sector is expected to grow stronger. There appears to be scope to increase the financial sector's role in reaching climate and energy targets in line with European and international commitments by adopting policy measures in the area of sustainable finance (such as sustainability disclosures, sustainable finance taxonomies etc.).

3. PUBLIC FINANCE

Fiscal consolidation continued in 2022 with a further reduction of the headline deficit due to solid revenue performance and a significant under-execution of the public investment budget. The headline budget deficit stood at 0.5% of GDP in 2022, which corresponds to a surplus of 0.2% of GDP under the fiscal rule definition ([4]). The 2022 deficit

([3]) Stable NPL ratio was also supported by the denominator effect, i.e. continued credit growth.

([4]) The fiscal rule places a cap on the fiscal deficit of 2% of forecast GDP, excluding capital projects financed by privatisation proceeds and donors ('investment clause'). This exemption for donor-financed investments can be invoked until 2025, provided the public debt ratio remains below 30% of GDP. A further rule provides that the increase in the public wage bill cannot exceed nominal GDP growth. Government deposits used as fiscal outturn was lower than in 2021 (1.2% of GDP) and significantly undershot the target of 5.4% set in the revised 2022 budget. Government deposits fell slightly to 3.5% of GDP from nearly 4% in 2021 mainly caused by financial support packages targeting vulnerable households and public energy companies. The lower deficit resulted primarily from a strong and higher-than-projected increase in government revenue (+13.2% year-on-year), largely on the back of high inflation and some formalisation gains. Tax revenue increased by 14.3% with direct and indirect tax income growing healthily by 24% and 13% respectively in 2022. Public expenditure grew by 10.5% year-on-year, mainly driven by transfers and subsidies (26.3%), in particular energy subsidies. The temporary support packages adopted to mitigate the impact of the energy crisis, including energy subsidies and transfers to households and businesses amounted to 3.5% of GDP in 2022. The execution of overall current expenditure was roughly in line with the revised budget plan. Wages and allowances recorded an annual decrease of 2.2% while spending on goods and services rose by 9.4%. Capital spending almost stagnated compared to 2021 and only reached around 60% of the revised budget allocation. It was affected by insufficient technical capacity and higher input prices, which led to a surge in project costs.

The ERP objective for 2023-2025 is to maintain stable public finances and comply with fiscal rules while supporting the economic recovery mainly through higher capital spending. The fiscal strategy is frontloaded. The ERP expects public revenue to rise by 1.5 pps to 29.3% of GDP in 2023 before falling back to 28% in the following 2 years. This is chiefly due to an expected tax revenue increase to an historical high of 26% of GDP in 2023 compared to 25.2% in 2022. Non-tax revenue is projected to rise to 3.3% in 2023 and then stabilise at around 2.5% of GDP on average. Public expenditure is projected to increase by 4.4 pps to 32.8% of GDP in 2023 and decrease gradually to 30.4% and 29.2% in the following 2 years. The ERP assumes a very large upfront increase in capital spending in 2023, bringing public investment to above 8% of GDP, and it is expected to remain at around this level over the programme period. Current spending is set to fall gradually, from 23.8% of GDP in 2023 to 20.5% in 2025, mainly on the back of a steady decrease in social transfers and subsidies. The headline deficit is expected to widen to 3.4% of GDP in 2023 and narrow afterwards. According to the fiscal rule's definition, the deficit is projected to fall to 1.1% of GDP in 2024 before turning into a marginal surplus of 0.1% in 2025. The implied fiscal impulse of about 2 pps in 2023 seems appropriate to support economic activity given the economic slowdown in 2022 and the estimated negative output gap before fiscal consolidation resumes in 2024-2025.

The 2023 budget plan aims to provide a significant fiscal impulse primarily through a big increase in spending driven by investment. The 2023 budget projects public revenue at 29.3% of GDP, compared to the 2022 outturn of 27.8% of GDP. Tax revenue gains are expected to come from higher GDP growth, a further reduction of the informal economy and improved tax compliance. Revenue growth will also benefit from a large increase in grants to 1% of GDP, mostly from EUR 75 million of EU budget support to Kosovo to cushion the impact of energy price increases on households and firms. The assumed rise in tax proceeds looks ambitious, especially without any policy measures to widen the tax base.

Total expenditure is planned to increase sharply to 32.8% of GDP from 28.4% of GDP in 2022, mainly due to the GDP rise of 3.6 pps in public investment spending. Compared to the outturn of 2022, capital spending is set to roughly double. Such a surge appears overly

buffers are legally required to stay at 4.5% of GDP as long as the government uses privatisation proceeds. The debt rule provides that public and publicly guaranteed debt cannot exceed 40% of GDP.

optimistic given the previous track record of implementing spending and would require a comprehensive overhaul of the institutional framework for investment planning and management. Current expenditure is set to increase by 0.6 pps to 23.8% of GDP in 2023, largely driven by higher spending on goods and services. Implementation of the Law on salaries of public officials, which came into force on 9 February, is expected to increase the wage bill by 0.3% of GDP. Subsidies and transfers are forecast to fall to 11.2% of GDP. This reflects the government's intention to gradually improve the quality of public spending by decreasing less growth-enhancing budget allocations as well as the withdrawal of support related to the energy crisis. Debt interest payments are set to increase marginally to 0.5% of GDP in 2023. The 2023 budget includes an allocation for contingencies of 3.5% of GDP, out of which 2.7% of GDP is a blanket allocation. Such large blanket allocations undermine fiscal transparency and budget planning unless they are justified as part of a concrete risk assessment framework. The headline deficit is forecast at 3.4% of GDP, which would keep the deficit (as measured according to the fiscal rule's definition) at the prescribed ceiling of 2% of GDP. Government cash deposits are planned to rise slightly to 4% of GDP from 3.5% in 2022, which is still in line with the prescription of the fiscal rule as no privatisation proceeds are planned.

Table 3

Kosovo - Composition of the budgetary adjustment (% of GDP)

	2021	2022	2023	2024	2025	Change: 2022-25
Revenues	27.7	27.8	29.3	28.1	28.0	0.2
- Taxes and social security contributions	24.8	25.1	26.0	25.7	25.7	0.5
- Other (residual)	2.9	2.7	3.3	2.5	2.4	-0.3
Expenditure	28.9	28.4	32.8	30.4	29.2	0.8
- Primary expenditure	28.5	28.0	32.3	29.9	28.7	0.7
of which:						
Gross fixed capital formation	5.3	4.7	8.3	8.4	8.0	3.3
Consumption	12.5	11.3	12.6	11.7	11.1	-0.2
Transfers & subsidies	10.6	11.9	11.2	9.6	9.4	-2.5
Other (residual)	0.1	0.1	0.2	0.2	0.2	0.1
- Interest payments	0.4	0.4	0.5	0.5	0.5	0.1
Budget balance	-1.2	-0.5	-3.4	-2.2	-1.1	-0.6
- Cyclically adjusted	-1.2	-0.1	-2.0	-1.7	-1.6	-1.5
Primary balance	-0.8	-0.1	-3.0	-1.8	-0.6	-0.5
- Cyclically adjusted	-0.8	0.3	-1.5	-1.2	-1.1	-1.4
Gross debt level	21.5	19.8	22.6	23.0	23.8	4.0

Sources: Economic Reform Programme (ERP) 2023, Commission calculations.

General government debt is projected to remain well below the ceiling of 40% of GDP set in the fiscal rule although weaknesses linked to a narrow investor base and a lack of market access remain. On the back of a marginal primary deficit and high nominal GDP growth in 2022, the debt-to-GDP ratio decreased to 20.7% from 21.5% in 2021. This is well below the 2022 ERP projection of 26.5%. However, the figures do not factor in the liability from COVID-19-related tax-free withdrawals of 10% of pension savings from the Kosovo Pension Saving Trust (KPST), which the government promised to reimburse from 2023 ([5]).

([5]) The IMF estimates the liability to KPST at 1.8% of 2020 GDP.

Domestic debt, which is held by a narrow investor base, increased marginally by 0.5% in 2022. The share of domestic debt held by the KPST grew to 49% compared to 44% in 2021, whereas the share of commercial banks fell to 25% from 29%. The Central Bank of Kosovo holds a further 19% of domestic debt. In February 2023, the KPST's investment in government bonds amounted to 22.2% of its total assets; therefore, it still has some room to buy new bond issuances before it reaches the legal limit ([6]). However, there is a lack of quorum in the KPST Board, and the KPST may not be able to participate in the auction of Kosovo government securities before new board members are appointed. Foreign debt rose by 11.2% in 2022 on the back of financing from international donors. This includes loans from the World Bank (EUR 60.1 million), the European Investment Bank (EUR 23.8 million), the European Bank for Reconstruction and Development (EUR 14.5 million) and the Council of Europe Bank (EUR 10.8 million). The ERP assumes a 2.8 pps increase in the public debt ratio in 2023 to 22.6% and a continued gradual drift upwards to 23.8% in 2025. It projects government deposits to reach 4% of GDP in 2023-2025, which would provide sufficient capacity to absorb potential new shocks.

Kosovo cannot access international debt markets as it does not have an international credit rating, and risk management policies limit the ability of commercial banks to hold more government debt ([7]). Therefore, the investor base for government securities needs to be more diversified to ensure adequate financing. This could include insurance companies, non-financial private firms and possibly retail investors, including among the diaspora. Together, these categories currently hold only 7% of domestic debt. In 2021, Kosovo issued its first diaspora bonds totalling EUR 10.4 million, most of them being 5-year bonds, in an effort to tap additional sources of financing. The new Law on public debt and state guarantees aligning the legal framework with EU standards and international practices was adopted at the end of 2022, and the secondary legislation will be reviewed and approved by the end of 2023. According to this new law, the definition of public debt will also include debt issued on behalf of municipalities. The law regulates municipality borrowing, including the power to borrow, reporting requirements and debt limits.

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(6) Government securities should not exceed 30% of KPST assets.

(7) The absence of a sovereign risk rating results in a 100 per cent capital risk weight for Kosovo's government securities.

Debt dynamics

Kosovo					
Composition of changes in the debt ratio (% of GDP)					
	2021	**2022**	**2023**	**2024**	**2025**
Gross debt ratio [1]	**21.5**	**19.8**	**22.6**	**23.0**	**23.8**
Change in the ratio	-0.9	-1.7	2.8	0.3	0.8
Contributions [2]:					
1. Primary balance	**0.8**	**0.1**	**3.0**	**1.8**	**0.6**
2. "Snowball" effect	**-2.8**	**-1.9**	**-1.3**	**-1.1**	**-1.1**
Of which:					
Interest expenditure	0.4	0.4	0.5	0.5	0.5
Growth effect	-2.1	-0.8	-1.0	-1.3	-1.4
Inflation effect	-1.2	-1.6	-0.8	-0.3	-0.2
3. Stock-flow adjustment	**1.1**	**0.1**	**1.1**	**-0.3**	**1.3**

[1] End of period.

[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).

The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other effects.

Source: Economic Reform Programme (ERP) 2023, Commission calculations.

The sustained though steadily decreasing primary deficit in 2023-2025 is expected to be the main factor behind the gradually increasing public debt ratio. This debt-increasing factor is set to be partly offset by the impact of robust economic growth and inflation. Interest expenditure is forecast to stay low and stable at 0.5% of GDP in 2023-2025. Positive contributions to the debt-to-GDP ratio are expected to come from stock-flow adjustments in 2023 and 2025, although this is not explained in the ERP.

The fiscal scenario is subject to significant fiscal risks and uncertainties. Fiscal projections are likely to underestimate current spending while the assumption of a huge surge in capital spending in 2023 appears unrealistic. On the spending side, the increase in allocation for social transfers seems rather moderate; the programme remains elusive as to the factors that could trigger the expected and significant drop in social and transfer spending as a percentage of GDP over the programme period. The ERP does not provide much detail about continuing the economic revival programme and energy subsidies to households and firms in 2023. In addition, risks of higher-than-planned growth in social spending persist due to new initiatives included in the government programme such as raising basic pensions or extending maternity and child benefits; existing schemes might prove more costly than expected. In particular, transfers and subsidies in 2023 might increase more than the targeted 3.4% compared to the 2022 outcome because of the recurring spending overrun on war veteran pensions in the absence of a reclassification of beneficiaries. The proposal to decouple war veteran pensions from the minimum wage would, once adopted, help contain overspending risks. The projected almost doubling of capital spending, compared to the 2022 outturn, seems overly ambitious given the track record in previous years and limited progress in improving planning, selection and management capacities of public investment.

Additional fiscal risks stem from the poor financial oversight and accountability of publicly owned enterprises (POEs), which could require (further) large subsidies from the budget, especially due to the energy crisis. The newly established sovereign wealth fund managing state assets is set to have a key role in improving POEs' financial performance. The stipulated reimbursement from the budget for the COVID-19-related 10% withdrawal of pension savings from the Kosovo Pension Saving Trust (KPST) is EUR 101.5 million, and it has been included in the medium-term expenditure framework (MTEF). The framework provides for five annual instalments of EUR 20 million each as of 2023. However, the 2023 budget only allocates EUR 5 million for reimbursement. It is positive that the government has rejected a recent proposal to withdraw more funds from the KPST. On the revenue side, the projected rise in tax revenue of around 14% in 2023 looks ambitious, with revenue gains expected to come from increased formalisation of the economy and sustained price increases. However, the ERP does not outline any reforms to widen the tax base. Overly optimistic GDP growth projections are also a downside risk for revenue.

Sensitivity analysis

The ERP analyses the sensitivity of the debt-to-GDP ratio to three specific shocks:

1) A slowdown in GDP growth of 2 percentage points would bring the debt-to-GDP ratio to 32.6% by the end of 2035 instead of 29.8% in the baseline scenario if the deficit rule is followed in 2025-2035.

2) If, due to higher spending, the primary balance deteriorates by 2 percentage points of GDP in 2025-2035 and the deficit rule is not followed, debt would increase to 34.3% of GDP by the end of 2035, i.e. 4.5 percentage points higher than in the baseline scenario.

3) A 1 percentage point increase in interest rates on loans combined with no compliance with the deficit rule would bring the debt-to-GDP ratio to 35.8% by the end of 2035, i.e. 6 percentage points higher than in the baseline scenario.

The sensitivity analysis underscores the importance of compliance with the 2% deficit rule, which acts as a debt stabiliser. Furthermore, it is important to keep current expenditure under control, in anticipation that financing from privatisation funds will end over the medium term.

A narrow tax base, unsuitable targeting and transparency of social transfers, and weaknesses in managing investments continue to harm the quality of public finance. The government allocated 4.3% of GDP in 2022 as fiscal support to vulnerable households, pension and salary bonuses, and subsidies for the energy and agricultural sectors. The measures could have been better targeted and more transparent, as some of them were aimed at all consumers and not just vulnerable households, such as energy tariff subsidies. A substantial share of specific category-based social transfers, including war-related pensions, that are non-contributory and financed from the budget do not directly target poverty reduction.

Further progress is needed to improve public investment management. The administrative guidelines on capital project selection and prioritisation, drawn up by the Ministry of Finance, Labour and Transfers in 2019, have not been implemented effectively. Project oversight is also weak, which impedes corrective action when needed. On a positive note, steps were taken to unlock the potential of project implementation, including through paid land expropriations and making the Procurement Review Body board operational again in the second quarter of 2022. Furthermore, the Law on public works support, adopted at the end of 2022, compensates contractors up until mid-2023 for higher project costs resulting from very high inflation; this may also improve the execution rate of capital spending. Kosovo should address shortcoming in managing public investment by progressing in the implementation of the recommendations made under the IMF Public Investment Management Assessment.

In addition to streamlining expenditure, Kosovo's public finances would benefit from strengthening the revenue base, which is weakened by the widespread informal economy, numerous tax exemptions, preferential tax rates and special regimes. Moreover, customs revenue in 2022 was lower as a result of the implementation of the free trade agreement with Türkiye and the Stabilisation and Association Agreement with the EU.

Kosovo's fiscal rules are the main anchor for macro-fiscal stability and safeguard high out-of-budget capital spending. The 2023 budget appropriately targets the deficit (according to the fiscal rule's definition) to be below the prescribed ceiling of 2% of GDP. The deficit is then expected to decrease further to 1.1% in 2024 before turning into a marginal surplus of 0.1% in 2025. However, the enforcement of the fiscal framework suffers from the unfinished reclassification of war veteran pension beneficiaries and continuously expanding social commitments. According to the fiscal rule definition, the exemption from the 2% deficit ceiling of capital projects financed by privatisation proceeds and donors can be invoked up until 2025, provided that public debt remains below the prescribed ceiling of 30% of GDP. A benign ERP projection of public debt is dependent on high GDP and public revenue growth, which are beset by uncertainty. The implementation of the Law on salaries of public officials is expected to increase the wage bill by 0.3% of GDP in 2023, which is lower than the nominal GDP growth in 2021, thus the wage bill rule will be respected. Fiscal governance would also benefit from moving ahead with plans to set up an independent body for fiscal oversight. This can be done by reviewing and selecting one of the options described in the paper that had been prepared with the help of the IMF. The proper functioning of Kosovo's fiscal framework is also conditional on the quality of macro-financial statistics, which require substantial further improvement.

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

The Commission has conducted an independent analysis of Kosovo's economy and identified the main structural challenges to competitiveness and inclusive growth, drawing on Kosovo's own ERP and other sources. The analysis highlights a number of structural challenges across many sectors. The three most significant challenges are:

(i) Improving energy security and sustainability by reforming the energy sector, transitioning to renewables and tapping energy saving potential;
(ii) Encouraging sustainable employment by improving quality education and labour market needs
(iii) Reduction of the informal economy and improving the environment for doing business.

While there are several obstacles to inclusive economic growth and competitiveness, the identified key structural challenges have the most potential for boosting inclusive growth and competitiveness and therefore have real reform leverage. The government identified the same three issues as key challenges in their ERP.

Kosovo also needs to continue to tackle corruption, improve the rule of law, strengthen its institutions and improve the administration's capacity in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for the successful transformation of the economy. The Commission has been closely monitoring the issues of strengthening the rule of law and fighting corruption in the annual enlargement package report on Kosovo.

Furthermore, the country should proactively implement the Energy Community's Decarbonisation Roadmap to achieve the agreed climate and energy targets, and strive towards establishing a carbon pricing instrument compatible with the EU ETS.

Key challenge #1: Improving energy security and sustainability by reforming the energy sector, transitioning to renewables and tapping energy saving potential

An unreliable and undiversified energy supply and an extremely fragile energy sector remains a major bottleneck for Kosovo's economic development. The reliability of energy supply is still below the average for Europe and Central Asia. Despite some improvements, Kosovo ranks 90th in the world for ease of getting electricity (World Bank, 2020b). The lack of energy security gives rise to significant costs for business and represents the biggest obstacle to attracting high-quality foreign direct investment. According to data from the latest World Bank Enterprise Surveys, 59.9% of firms experienced electrical outages and there were 3.8 outages per month on average[8]. Energy demand and consumption continues to grow quickly, and has doubled since 2000. Kosovo also suffers from high technical and commercial losses in the distribution and transmission grids due to poor infrastructure (around 20%).

Kosovo is particularly dependent on outdated, unreliable and highly polluting energy production sources (brown coal/lignite). This, together with inefficient consumption and insufficient flexibility to adapt to consumption in peak periods, means that electricity must be imported and exported to balance the system. Since Kosovo tends to import at times of high prices and export at times of low prices, this mismatch creates significant costs. The cost of electricity imported from November 2021 to March 2022 reached EUR 204 million. The issue of energy security has become an even more urgent issue amid Russia's war of aggression against Ukraine and the global rise in energy prices.

Addressing Kosovo's energy issues is also challenging from an environmental point of view. The highly polluting Kosovo B thermal power plant requires an environmental upgrade while Kosovo A thermal power plant was to be decommissioned until the government recently included in the new national energy strategy the possibility to extend the lifetime of at least one of its units. Fuelwood, remains a significant energy source for heating homes due to cheaper prices, leading to significant air pollution and the attendant negative health effects, particularly during winter months. Furthermore, limited efforts have been made to improve support schemes for renewable energy projects. Lessons learned from the IPA 2015 biomass based heating plant with cogeneration technology in Gjakova should be taken into consideration because the power plant appears not to be sustainable at this stage.

The green transition has become a priority following Kosovo's endorsement of the Green Agenda for the Western Balkans during the Sofia Summit in November 2020. Kosovo has begun to diversify its energy supply. Renewable energy sources, currently account for just over 5% of electricity supply. By the end of 2021, Kosovo recorded a total of 276.2 MW of renewable electricity generation, 96 MW of small hydropower, 32 MW of large hydropower, 137 MW of wind, 10 MW of solar, and 1.2 MW of biomass. Kosovo has recorded a 24.4% share of renewables in 2020 just under its official target for the year of 25% 2020. While the share of energy from renewable sources in gross final energy consumption reached 24.2% and 22.4% in 2019 and 2021 respectively. . However, this was mainly achieved by revising the definition of renewable energy sources to include biomass for heating. The roll out of renewables is expected to accelerate through the newly adopted national energy strategy 2022-2031 and the law on renewable energies which is due to be adopted by the Assembly in Q3 2023. The draft law provides for a competitive bidding process for support for renewable energy projects to replace the previous system of feed-in tariffs. There has been an increase in renewable energy investments and several projects to develop significant wind and solar energy sources are already planned, including merchant projects to be operated outside of the auction process. In particular, the Western Balkans

(8) Data collected from business owners and top managers in 271 firms interviewed from December 2018 to October 2019.

Investment Framework board has approved two public-sector blending projects including the construction of a photovoltaic plant (100MW) and a solar district heating facility that will also involve the construction of solar collectors.

The potential for savings through energy efficiency measures remain significant. Some efforts were made to increase energy efficiency incentives for the private sector and households. There is some progress on energy efficiency retrofitting of the public buildings implemented by the Kosovo Energy Efficiency Fund with financing from EU, World Bank and Kosovo budget. The fund intends to expand the operation in the residential sector starting in 2023 with financing from the EU under the Energy Support Package. The government has taken progressive steps to help overcome the current energy crisis, and already rolled out Energy Efficiency measures for subsidising efficient heating equipment in the residential sector. Under the Energy support package, the energy efficiency fund will provide subsidies up to 50% for the implementation of the energy efficiency measures in the residential sector. Further work is under way towards the finalisation of the national energy efficiency programme. The European Bank for Reconstruction and Development, supported by the EU and in partnership with local partner banks and micro-finance institutions, has begun providing credit for households (which account for 39% of final electricity consumption) to make their homes more energy efficient, and there is scope for more such investment. In 2022, Kosovo introduced new block tariffs to incentivise energy efficiency by increasing the price of electricity for users consuming over 800 kilowatts per month. Despite this step toward liberalisation, electricity prices remain highly regulated and are below the regional and EU averages.

The Economic and Investment Plan and the Green Agenda for the Western Balkans will contribute to the green and digital transition, in particular the use of renewable energy sources, which will benefit Kosovo's competitiveness. A substantial investment package, which is at the heart of the Economic and Investment Plan, will direct most support to key productive investments and infrastructure. This will reflect and support the twin green and digital transition and the development of a thriving economy that is connected, competitive, knowledge-based, sustainable and innovation-oriented. Circular economy principles, which form the basis of the Economic and Investment Plan and are defined in the Green Agenda for the Western Balkans, could boost levels of sustainable energy production and consumption significantly. Labour market transition can be difficult for some workers in particular of the mining sector. It is crucial to help workers to gain the needed skills to facilitate their transition towards the green economy by training, re-training and up-skilling.

***Reform measure 1: "Energy market reform*"** carries over reform measure 6 from last year's ERP and aims to address the problem of low levels of competition in the energy market by reviewing and amending legislation and regulation in the sector. The flagship activity under this measure is the operationalisation of the wholesale day ahead and intra-day electricity price markets within the framework of a joint Albania-Kosovo electricity exchange (ALPEX). Market integration will increase the utilisation of cross-border transmission capacities, enabling more efficient utilisation of electricity networks, and increasing competition for the benefit of customers. ALPEX is expected to be fully operational by Q3 2023. Although authorities see no obstacles to achieving this goal, the measure has already been delayed from last year and the authorities are dependent on the day-ahead and intra-day markets being established in Albania before Kosovo is connected to them.

Critically, around 90% of Kosovo's electricity production and supply is regulated under a bulk supply agreement between Kosovo Energy Corporation (KEK) and Kosovo Electricity Supply Company (KESCO). End prices for consumers are regulated by tariffs set by the Energy Regulatory Office (ERO). The authorities are currently exploring ways to reform the agreement to further liberalise the market, however this may prove to be complicated legally due to the agreement's indefinite duration. The establishment of a wholesale electricity market via ALPEX can be seen to serve as a pilot liberalisation of part of the market but the unreformed bulk supply agreement is significant legal obstacle to full market liberalisation. The retail market for supplying of high-voltage customers is deregulated.

Furthermore, this measure includes an activity to establish a platform for the comparison of electricity supply prices. It is unclear what benefits this platform bring given that there are currently only two suppliers of electricity operational in the market at present.

Reform measure 2: "Promotion of energy efficiency and renewable energy sources with a view to the green transition", combines two measures rolled over from last year's ERP and aims to prioritise energy efficiency in all sectors and increase energy generation through renewable sources. The roll out of renewables will be accelerated through the new national energy strategy 2022-2031 which has already been adopted by the government and Assembly.

Activities included under this measure are the adoption of the law on renewables as well as associated secondary legislation to provide for the introduction of a competitive bidding process for renewable energy projects to replace the previous system of feed-in tariffs. A first pilot auction is expected to take place in Q2-2023 before the law on renewables is in place. A project location has been found, preliminary studies are being conducted and the first tender currently being drafted. The financial impact assessment on the law on renewables is ongoing which is expected to be approved in Q3. Auctions under the new law are expected to begin before the end of 2023. State aid approval is still required for the auctions and may constitute an obstacle. Streamlining of permitting processes which can be a major obstacle to implementation of projects is not mentioned under this measure although some provisions for this are included in the draft law. In addition, the role of merchant structures including corporate Power Purchase Agreement (PPAs) should be reflected in the RES law, as there is a strong interest in this area from the private sector.

In relation to energy efficiency, activities include implementation of energy efficiency measures in public and private buildings. Currently the government and the Energy Efficiency Fund are in the process of designing the measures to increase energy efficiency in the residential and private sector and to provide energy efficiency incentives for households and the private sector. Financing of these measures will partially come from the EUR 75 million Energy Support Package for Kosovo..

It should be noted that the new national energy strategy sets the target of completing all preparations for implementing a carbon pricing system by 2025. This ambition is not fully reflected in the ERP submission and progress is needed on this front to avoid adverse effects due to the EU's Carbon Border Adjustment Mechanism.

Key challenge #2: Encouraging sustainable employment by improving quality education and labour market needs.

Micro, small and medium companies and subsistence farming are the backbone of Kosovo's economy and main employers. 99.9% of all Kosovan companies are SMEs and family-run businesses. They account for 80.4% (2020) of employment in non-financial businesses (significantly above the EU rate of 65.2%) and generate 81% of the total value added of the country[9]. The SME sector consists overwhelmingly of distributive trade

(9) *SBA fact sheet Kosovo*, 2019

businesses, which includes wholesale and retail trade and the repair of motor vehicles and motorcycles. 62% of the population lives in rural areas. Around 20% of the workforce works in agriculture, and there is many informal jobs. However, the sector's contribution to growth remains limited, and the loss of jobs in agriculture does not lead to retraining in other sectors. Net trade of IT services increased by over 200% compared to the first half of 2021, accounting for 11% of the total share of trade in services in the first half of 2022. Nevertheless, developments in digital technology and artificial intelligence have sparked concerns about new risks of poverty and social exclusion. Kosovo's Human Development Index (HDI) and Human Capital Index (HCI) are among the lowest in the region. About one third of the population lives below the national poverty line.

The public sector is the largest employer in the job market with 30.8% of total employment[10] (2018) compared to 27.2% across the Western Balkans and 23.7% in OECD-EU countries. Publicly owned enterprises in Kosovo provide important services, such as water supply, waste collection, electricity production, transport and telecommunications[11]. However, public utilities in Kosovo face challenges from over-staffing and poor performance among others. Staff recruitment is often in violation of fair and transparent recruitment processes. Over the years, publicly owned enterprises have paid higher salaries than the rest of the public sector, and the average salary is almost twice the amount of the private one.

The statistical data confirm a worrying situation in the labour market, particularly for young people and women. According to the 2021 Labour Force Survey (LFS), about 66% of the population are of working age (15-64); however, the official workforce participation rate is 39%. The discrepancy between the active labour supply and labour demand is very high. The gender divide is also significant. The inactivity rate for men is 43.4% (LFS 2021) compared to 78% for women[12]. The employment rate for men is 45.9%, while it is 16.5% for female. The unemployment rate (20.7%) further underlines the gender gap. Women make up 25% of unemployed people compared to 19% for men. 38% of young women (aged 15-24) are unemployed. The rate of young people not in education, employment or training (NEET) is 36.6% (group age 15-29). Publicly owned companies perform poorly when it comes to equal opportunities. Women's access to the labour market, especially in rural areas, is low due to many factors, including the traditional role given to women as housewife, limited access to childcare and flexible working arrangements, lack of care for older people, discouraging laws (for example, on maternity leave)[13] and ethnic discrimination. As indicated in the recent OECD report[14] 51% of women in the working-age population (15-64 years old) were only educated up to lower secondary education, compared to 27% of men.

The lack of work fuels the significant informal economy (around 31% of GDP) and emigration. 56.5% (LFS 2021) of employees have a temporary contract, which denies people their rights, including in the public sector where the use of special service agreements[15] is

(10) *Kosovo Country Economic Memorandum*, World Bank.

(11) *Financial Management and Transparency of Publicly Owned Enterprises*, December 2022, GAP Institute (GAP), Group for legal and Political Studies (GLPS) and Institute for Development Policy (INDEP).

(12) This is the largest gender employment gap among all WB6 economies

(13) Implementing legislation for the Law on protection from discrimination still has to be adopted. The current draft Law on labour proposes shifting the burden of paying maternity leave from businesses to government; however, it has yet to be adopted by the national assembly.

(14) *Labour Migration in the Western Balkans*, 2019, OECD

(15) Special service agreements (SAAs) or fixed-term appointments represent a way of recruitment with limited timeframe in civil service. SAAs are contracts concluded between the institution and one person who is a professional in a certain field and is assigned to provide that expertise for a period not longer than six (6) months.

widespread. This flexibility for employers creates insecurity for employees and an incentive to take on informal jobs. According to estimates, 40% of the workforce is not declared or is under-declared. Clientelism makes the public sector a more attractive place to work than the private sector[16]. In the 2021 May Public Pulse survey[17], the top three issues reported were unemployment (34.3%), poverty (19.3%) and corruption (9.3%). This leads to major emigration and the brain drain of mostly young, educated and skilled people looking for a better life. The Western Balkans is expected to lose around 1 million young people to other countries in the coming decade[18]. The loss of human capital, especially through emigration as well as demographic decline, is a big risk. It hinders economic growth, weakening the ability of the government to improve services, including education and social protection. The state strategy on migration for 2019-2023 underlined that brain drain has been emphasised as a concern by the government. Beyond the substantial remittances they generate, the skills and experience gained by emigrants abroad can benefit the Western Balkans if policies are in place to reap the full benefits[19].

Many reports highlight the urgency to invest in quality education at all levels to create better jobs, living conditions and prospects for young people. Kosovo has the youngest population in Europe with around 70% of the population under the age of 35. However, the country is unable to give these young people the education and the skills needed so that they can live from their work. According to these reports, based on the results of international tests, the education system is not geared to developing the necessary key skills, nor adequately aligned with the demands of the labour market. Based on regional surveys, the OECD[20] stresses that, 17% of respondents disagree with the claim that skills learned in the education system meet the needs of their job and 44% of surveyed firms identify applicants' lack of skills as a reason for unfilled vacancies. Students reach a bottleneck when they are old enough to earn a living. Without decent work, they are exposed to many other risks like poverty, human trafficking or health problems. Many find a job that does not correspond to their level of education. 41.7% of students (aged 15-24) in Kosovo are estimated to be over-skilled and employed in semi-skilled occupations (ISCO08[21] groups 4-8), usually requiring lower levels of formal qualifications. 32% of over-educated individuals hold jobs below their (ISCED) level of education[22]. European Training Foundation reports that many young Kosovars are opting for higher education since this improves their chances of employment even if this is in jobs requiring lower skills[23].

Career guidance is crucial for youth employment. Employers are reporting significant skills shortages[24]. The early identification of young talent to provide them with relevant

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(16)*Review of national career development support systems in the Westerns Balkans*, European Training Foundation (ETF)

(17)*Public Pulse Brief XX* | United Nations Development Programme

(18)*State Strategy on Migration 2019-2023.* The number of emigrants of Kosovan origin (period 1969-2011) is estimated to be about 703 978 people, while in 2017 it was estimated to be about 833 739 (net migration stock) people. Most of them live in Germany (39%), Switzerland (23%), Italy (7%), Austria (7%) and Sweden (7%), and 17% live in other countries.

(19)*Labour migration in the Western Balkans: mapping patterns, addressing challenge and reaping benefits*, 2022, OECD

(20)*Labour Migration in the Western Balkans: Mapping Patterns, Addressing Challenges and Reaping Benefits*, 2022, OECD

(21)International Standard classification of occupations.

(22)*KIESE 2022,* European Training Foundation ETF

(23)*Review of national career development support systems in the Westerns Balkans*, European Training Foundation ETF

(24) Findings show that the most in-demand skills are socio-emotional, foreign language, and computer skills.

education and opportunities is weak. Without relevant and real-time data, it is difficult to align policies, training programmes and curricula with the current and future needs of the labour market and guide students into careers best suited to their skills and preferences[25]. For instance, the 2017-2026 Energy Strategy mentions that implementing energy efficiency measures includes creating new jobs and developing local businesses. However, no details are given about the type of skills required or the benefits for local businesses. Consequently, the Public Employment Services, with its network of training providers and with the participation of donors, provide targeted training but for a limited number of jobseekers. Older people, women, people with low or no qualifications and the long-term unemployed may face particular challenges to access training courses that lead to employment. These particularities are hardly taken into account. The authorities have recently started to use tools that will give them an overview of market needs and let them publish the results[26].

Limited practical skills and work experience opportunities is a major constraint for the school to work transition. Due to their small size, businesses are not sufficiently involved in education or training and do not provide enough opportunities[27] to their staff, including further skills development[28]. However, progress is being made, notably the launch of dual-education and work-based learning programmes. For instance, the K-GenU platform[29] was created and aims to empower 10 000 young people by giving them internship opportunities, mentoring and training in the next 2 years. The implementation of the youth guarantee should also ensure a better partnership between all the relevant bodies (Relevant ministries, employment services, training providers, social services, civil society and social partners) supporting those who are furthest from employment. Although a Donor Coordination Group within the Ministry of Finance, Labour and Transfers and the Ministry of Education, Science, Technology and Innovation exist, the coordination among donors remains weak as well as the degree of ownership and steering by the authorities.

The lack of financial autonomy of vocational schools is a major reason for skills mismatches. Part of the upper-secondary education, the vocational education and training (VET) system involves many stakeholders, which makes its governance complex. According to the education law, municipalities are responsible for paying salaries of the support/administration staff and teaching staff and deciding on the allocation and reallocation of funds for each VET school. Municipalities are not sufficiently monitored by the central level (ministries of finance and education) whether they use the grants earmarked for education or VET purposes. Around 90% of the budget goes on wages, and the remaining amount is insufficient for maintenance and investments in quality teaching. VET funding – and pre-university education in general – is a delicate matter but needs to be tackled quickly. The IPA-ADA ALLED2 project has suggested a valid, new financing formula for VET.

The VET curriculum is too theoretical and does not teach the necessary practical skills. Only a few VET curricula or courses offered by public VET institutes (schools or

(25) Busulla.com is the official portal of the Ministry of Education, Science and Technology for professional orientation, education and career consulting.

(26) *Atomi project* – Raiffeisen Bank.

(27) *Job Creation and Demand for Skills in Kosovo: What Can We Learn from Job Portal Data? "*The absence of internships on the main job portals is of concern for young people looking for experience in a labour market dominated by informal networks", Calogero Brancatelli, Goethe University Frankfurt, Alicia Marguerie, World Bank, Stefanie Brodmann, World Bank.

(28) *STEP survey*, World Bank Kosovo.

(29) The Ministry of Finance, Labour and Transfers, in partnership with UNICEF, Reifaisen in Kosovo and the Kosovo CSR Network.

training centres) are based on qualifications accredited by the National Qualifications Authority[30]. A lack of skills affects all firms looking for staff, but it affects large, dynamic and innovative firms even more. Therefore, the firms that are more likely to be competitive and productive are also the ones facing the largest skill constraints when recruiting. VET school infrastructure remains insufficient with either outdated equipment or no equipment at all. Teachers need proper training to face fast-changing technologies. Employers should be more involved and encouraged to participate in the improvement of programmes alongside international experts. However, professional practice is not currently implemented in a systemic way and does not follow the curricula. Hiring new state inspectors is ongoing and needs to be reinforced; inspectors should mainly check the quality of teaching rather than compliance with the law. A number of donor initiatives are being implemented on work-based learning and the ongoing implementation of incubators providing support and coaching for new businesses (i.e. Innovation Center Kosovo[31]) is a promising initiative.

Early childhood development recently became a top priority in the national development agenda[32]. The draft Law on early childhood education (ECD) was adopted by the government in July 2022 and is now in parliamentary procedure. A high-level ECD Steering Committee, with strong leadership and representation from key government ministries, has been set up to improve implementation and coordination of programmes. Funding will also be increased in line with quality benchmarks to develop infrastructure, in particular in rural areas, to revise and adapt the curriculum (to be approved in 2023) and to train qualified staff. Communication will be improved to better inform parents about the benefits of preschool education and early childhood development. Municipalities play a central role in financial allocations to schools. However, due to this decentralised model, the allocated funds are insufficient and can be reallocated. A child who starts school at the age of 4 can expect to complete 13.2 years of school by their 18th birthday, but their education level is equivalent to completing 7.9 years of school33. Only 15% of children aged 3-4 in Kosovo attend some form of early childhood education34. While ECD enrolment is low, the system itself is diverse with public, private, and community-based services. The preschool enrolment rate is expected to rise rapidly now that enrolment is made compulsory.

The Education Strategy 2022-2026 has been adopted and aims to raise the quality of pre-university education and, in particular, harmonising education and professional training based on the 'Evaluation of the Implementation of the Kosovo Education Strategic Plan 2017-2021' (KESP). This evaluation report provides an overview of steps that have been taken so far to meet the strategic objectives. It also makes recommendations about how to use the KESP as a platform to improve the quality of education. In particular, in the Education Strategy, the authorities make a commitment to improve the link between education and the needs of the labour market. They commit also to develop the use of digital technologies to

(30) *Job Creation and Demand for Skills in Kosovo: What Can We Learn from Job Portal Data?* Calogero Brancatelli, Goethe University Frankfurt, Alicia Marguerie, World Bank, Stefanie Brodmann, World Bank.

(31) Innovation and Training Park in Prizren (ITP).The main sectors developed within the ITP are: information technology, agriculture and food processing, creative and cultural industries and vocational training. The park is now open, and businesses are applying to become part of the ITP.

(32) *Why investing in the early years of children's lives is critical in Kosovo*, Worldbank

(33) World Bank

(34) *Annual Report 2021*, Unicef Kosovo

improve the quality of education. A planned priority is for the Kosovo Accreditation Agency[35] to strictly monitor the criteria for accrediting higher education programmes.

With the cooperation of the Kosovo government, the European Training Foundation carried out an evidence-based rapid education diagnosis[36] of the entire education system addressing three main thematic areas: inequality, financing and governance. The analysis aimed to identify key issues and actions to improve the quality and delivery of education services overall. The Foundation drew up a set of recommendations for the Kosovo authorities to consider. These recommendations include: (i) setting up adequate monitoring and evaluation mechanisms; (ii) improving cross-ministerial cooperation; (iii) boosting institutional capacity, particularly for financial management; and (iv) setting priorities in the Education Strategy.

Reform measure 3: 'Adapting Vocational Education and Training to the needs of the labour market'. This measure is carried over from previous years and presents an integrated approach to address long-term issues in the VET sector. The reform seeks to give young people a first work experience and recognise qualifications for increased employability according to labour market needs. A large part of the current VET profiles and curricula is still outdated: only 30% of the more than 180 VET profiles are based on occupational standards (Bajrami 2021). VET programmes need to be further revised and developed, but no related concrete activities or indicators are described. Preparatory work is particularly important before further implementing dual-learning. Currently there are only four active dual-learning profiles with around 100 students concentrated in low-skilled professions while some 5,000 VET students (funded by donors) from schools and programmes benefit from company internships. Furthermore, ensuring the autonomy of VET institutes and a better collaboration with employers is necessary to improve teaching and practice of trades.

Reform measure 4: 'Increasing and ensuring quality in higher education by strengthening the KAA and profiling higher education institutions' is rolled over from last year's reform measure 2 and is well designed. However, there have been implementation delays. The adoption of the law on the Kosovo Agency for Accreditation has been rolled over from last year. The draft law addresses the recommendations made by the European Association for Quality Assurance in Higher Education (ENQA) and the European Quality Assurance Register (EQUAR). The draft law must be passed and resources secured for its implementation this year. The measure does not include activities that could improve the quality of courses or better link education with businesses.

Reform measure 5: 'Reforming labour market institutions and policies to raise the level of employment, participation in the labour market and effective protection of labour rights' is rolled over from last year's ERP measure 5. The measure focuses on the reform and modernisation of the employment service (EARK), and the activities outlined would provide a good start to implementing the youth guarantee scheme. Strengthening human resources in the

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(35) The Kosovo Accreditation Agency (KAA) is an independent body responsible for assessing and promoting the quality of higher education. It is currently in the process of applying for membership in the European Network for Quality Assurance in Higher Education (ENQA) and European Quality Assurance Register (EQAR). KAA has been granted the status of affiliated member of ENQA recently, and this is an assurance that the agency is on the right path towards its full membership of the organisation (9 out of 11 recommendations has been fully addressed, while the other two have already been addressed through legislation and will be considered implemented as soon as the Law on Accreditation Agency is enforced). Through quality assessments and quality audits, KAA is firmly establishing a quality of higher education in Kosovo that meet the demands and expectations of the European Network.

(36) *Kosovo Rapid Education Diagnosis (RED): addressing the weak links*, European Training Foundation ETF, forthcoming (2023).

employment agency depends on recruitment opportunities in the public sector. This is crucial issue given the retirement of many employees. Digitalisation of services would accelerate the flow of information and improve the quality of services in line with supply and demand. The development of employment and skills surveys must be continued to give greater visibility to the needs of the labour market. The lack of financial resources is still a challenge in tackling inactivity and unemployment.

Restructuring the labour inspection service and employing 100 new labour inspectors are welcome initiatives. The 2023 budget has already earmarked budget for this measure, and this will help the formalisation of employment and the effective protection of labour rights.

Monitoring performance on the European Pillar of Social Rights

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights concerning equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. Since the 20 principles are essential for countries if they are to achieve fair and well-functioning labour markets and welfare systems, they are equally relevant for candidate countries and potential candidates. The new reinforced social dimension for the Western Balkans includes an increased focus on employment and social reforms through greater monitoring of relevant policies (EC, 2018). The Western Balkans Ministers' Declaration on improving social policy in the Western Balkans (6 November 2018) confirms that the ministers will use the Pillar to guide the alignment of their labour markets and welfare systems with those of the EU.

For most of the Pillar's principles, Kosovo performs considerably below the EU average according to the Social Scoreboard indicators[37]. Nevertheless, the downward trend is now being reversed due to reforms launched or in progress. The share of young people and women in the job market, which is still very low due to skills mismatches and a lack of opportunities, should increase as a result of several initiatives. However, the pace of legislative approval of these initiatives needs to accelerate.

KOSOVO		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Better than EU average, improving
	Gender employment gap	Worse than EU average, improving
	Income quintile ratio (S80/S20)	N/A
	At risk of poverty or social exclusion (in %)	Worse than EU average, trend N/A
	Youth NEET (% of total population aged 15-24)	Worse than EU average, deteriorating
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU average, deteriorating
	Unemployment rate (% of population aged 15-64)	Worse than EU average, deteriorating
	GDHI per capita growth	N/A
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	N/A
	Children aged less than 3 years in formal childcare	Worse than EU average, trend N/A
	Self-reported unmet need for medical care	N/A
	Individuals' level of digital skills	Worse than EU average, improving

The reform of the education system is ongoing but still at an early stage. The focus is on expanding early childhood education and care, which is well below EU levels. This should benefit the poorest families. The independent agency responsible for the external evaluation (accreditation, re-accreditation, validation and follow-up) of higher education institutions in Kosovo is now operational.

There are still limited employment opportunities on the labour market. Clientelism remains widespread in the public sector, which is the country's main employer. Enforcing labour laws and working conditions remains unclear despite some progress in the private sector. Brain drain is a threat.

Ambitious reforms of the social assistance and healthcare systems are planned. However, the social assistance reforms have been delayed in the legislature, and healthcare reforms have been slowed due to the COVID-19 pandemic.

The statistical system is at an early stage of development. Kosovo Agency of Statistics conducts a quarterly Labour Force Survey based on EU methodology. The quality of the data needs to be improved. Statistics on Income and Living Conditions are not yet collected. Specific challenges exist in setting indicators based on population data, e.g. in education.

(37)The table in this box includes 14 of the Social Scoreboard's headline indicators, of which 12 are used to compare the performance of EU Member States (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators) and also of the Western Balkans countries and Türkiye. There is just one small adjustment in the age bracket for the unemployment rate (reducing the upper-age limit to 64 instead of 74) for Albania and Kosovo due to data availability. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; 2019 data are generally used for this comparison) and a review of the trend for the indicator based on the latest available 3-year period for the country (improving/deteriorating/no change). Data from 2017-2019 are used and can be found in Annex A.

Key challenge #3: Reduction of the informal economy and improving the environment for doing business.

The informal economy has a widespread and significant impact on Kosovo's GDP (31% according to the most recent estimates, against a European average of 15-20%). An EU-funded project estimated the preliminary cost of this problem to be around EUR 106.8 million as a result of lost income tax revenue and VAT alone (IMF, 2019). This harms Kosovo's competitiveness and attractiveness for private investors, including foreign direct investment (4% of GDP in 2021 and 5% in 2022, largely driven by diaspora investment in the real estate sector), formal employment levels (39.3% in 2021) and the associated social and fiscal benefits and the public budget.

Informality has many significant negative consequences for the economy. First, it reduces the tax base, limiting the fiscal space for more investment in priority areas, such as education, health and infrastructure. Second, it creates an uneven playing field amongst businesses and is a deterrent for additional, much-needed private sector investment, including foreign direct investment. Unfair competition from informal businesses has consistently been identified as a major obstacle to doing business in Kosovo (World Bank et al, 2019a; EBRD, 2016)[38]. The informal economy also affects the competitiveness and export potential of Kosovo's private sector: firms in the informal sector have more difficulty accessing finance and tend to engage less in research and development and innovation and to hire fewer workers. Lastly, workers in informal sectors have more limited (or no) access to social protection and additional benefits and are more vulnerable when they lose their job or leave the labour market. Their access to training is also negatively affected, which further exacerbates the inadequacy of the skills of the workforce and contributes to the migration of specialised and skilled workers to markets where better labour and wage conditions can be found. Conversely, the lack of social and other benefits in formal employment – given the lack of existing structures to provide them – discourages many informal employers and employees from formalising working arrangements.

Kosovo's widespread informal economy is linked to the general low level of trust in government and institutions and to weak enforcement. High tax rates are not considered to be a major contributor to the phenomenon in Kosovo (income, individual and VAT tax levels are relatively low when compared to regional and other European economies). In a global ranking, Kosovo was placed in a mid-ranking 48th place in the 'paying taxes' subcategory of the 2020 World Bank *Doing Business* Report. This indicates an overall low level of law enforcement and tax control on the part of local authorities as a potential underlying cause of high levels of informal work, though there has been recent progress on this front. In addition, efforts must be made to improve trust and confidence in the judicial system in order to improve certainty in contract enforcement. In a recent survey, 43% of firms identified the court system as a major obstacle to doing business (World Bank, 2020). Other challenges include: (i) the weak institutional set-up for updating and exchanging information on businesses; (ii) an inefficient and costly inspections system; (iii) the large number of licences and permits required; and (iv) slow, and unreliable contract enforcement. The digital

(38) The *2019 Enterprise Survey* put informality as the single most pressing obstacle perceived by business in Kosovo, with 26% surveyed companies listing it first, well above the 19% of surveyed firms in the region selecting this option (WB et al., 2019). Similarly, according to the 2016 business environment and enterprise performance survey (BEEPS V), competition from informal competitors was signalled as the single most important issue in Kosovo. In all, 66% of firms reported that having to compete against firms in the informal sector was a major issue, the highest among all 30 countries covered in BEEPS V (the average was 39%). (EBRD, 2016)

transition offers an opportunity tackle this issue. A range of measures could be taken to improve the business environment, including the simplification, merging and abolition of licences and permits and speeding up commercial dispute settlements. However, some progress has been made recently with the establishment of a dedicated Commercial Court. The ambition set out in the new Administrative Burden Reduction programme is a good basis, but further work is needed on its implementation. Some progress has already been made on the digitalisation of public services, but Kosovo is still at an early stage of development in this area compared to its peers in the region.

The National Strategy of the Republic of Kosovo for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes 2019-2023, was adopted in May 2019. It sets out measures to address the informal economy and provides for improved monitoring mechanisms. An implementation report covering the first half of 2022 showed that only 50% of the planned actions were implemented. A second action plan covering the period 2022-2023 was adopted in 2022 and contains improved indicators and activities in key areas such as statistics, business registration and better inter-agency cooperation. Among the targets set for 2023 are the reduction in the size of the informal economy to 26% of GDP, the reduction of the informal employment rate to 10% and an increase in the final confiscation of criminal assets.

Recent formalisation and compliance efforts by Kosovo's Agency of Statistics (KAS), and Customs have produced results. According to recent IMF estimates, formalisation and improved compliance have contributed to a cumulative change in tax revenues in 2020–22 of around 35%. Inflation, which contributed to around 65% of the cumulative increase in revenues, reflected price pressures, such as commodity prices and wage increases (IMF 2023). These efforts include emergency measures taken during the early stages of the COVID-19 crisis. The measures prompted undeclared and informal workers to register, and businesses to disclose turnover and profit figures in order to be considered for business and employment support schemes.

Reform measure 7: "Reducing the informal economy by improving intelligence-based oversight" is rolled over from measure 10 in last year's ERP. It aims to increase formalisation primarily through improved compliance. Recent progress made in the area of tax compliance serves as a basis for this measure. The activities outlined seem credible and significant to tackle to some degree the issue of the informal economy. The 2023 budget law provides for increased staff in the Tax Administration, Customs and Labour inspectorate making more inspections and oversight possible. The development and improvement of electronic services to facilitate filing and paying of taxes is a welcome activity. A measure to increase the number of electronic payments in the economy is not included, even though this would help to formalisation.

The proposed indicator of higher tax revenue is not suitable as progress can be skewed by inflation. A better indicator would focus on the size of the tax gap, for which more consistent monitoring is required. The indicator measuring the number inspections is credible and welcome.

Kosovo's formal entrepreneurial landscape is dominated by non-specialised, family-owned micro-companies characterised by low productivity and export competitiveness. This is directly reflected in the persistently high current account deficit figures (8.7% in 2021 and 6.1% estimated. in 2022)[39]. and more so in the much higher deficit in trade of goods (47.6% in 2021 and 51.4% estimated. in 2022). The export of goods did increase by 26.1% (January to October 2022) with "base metals and articles of base metals" continuing to make up the largest share (23.8% in total exports). However, there were also increases in exports for other categories (e.g. furniture, mattresses, plastic and rubber). While the increase in export of services of 32.6% (January to October 2022) was driven largely by tourism, exports of ICT services also grew by 119.8%. ICT services remain a small share of total exports but have the potential for rapid growth. The narrowing of the current account deficit in 2022 was driven mainly by the dramatic increase in the export of services; remittances only increased moderately.

While the increase in the export of goods and services is welcome, Kosovo's exports are too concentrated and dependent on a few key sectors. Kosovo lacks a clear strategy to reduce its overall trade deficit and needs to diversify its exports especially into higher value-added goods and services If no action is taken in this area, Kosovo's trade and current account deficits are likely to remain high and the economy will continue to depend on remittances.

Foreign direct investment (FDI) and remittances, which could help offset the current account's deficit, are unable to fill the gap and have not led to an increase in domestic productivity. Kosovo has primarily attracted investment in areas with limited scope for productivity spill overs such as construction and real estate representing 80% of FDI (IMF, 2023). According to authorities, real estate accounted for 67.8% of total FDI, followed by "financial and insurance activities" with 7.3% between January and October 2022. Kosovo lacks a comprehensive strategy to proactively target investors and attract FDI. Inter-agency coordination mechanisms in this area are also weak. The Kosovo Investment and Enterprise Support Agency (KIESA) is active in this area but its resources and capacities are not sufficient to match the ambition of its broad mandate (OECD, 2021b). The restructuring and reform of KIESA is long overdue. Additionally, FDI is limited to a handful of countries, namely states where a sizeable, well-established Kosovo diaspora exists. Export-oriented FDI has been very scarce, and overall figures are relatively low, passing the EUR 300 million figure only once in the past 7 years. Remittances are used almost exclusively for consumption purposes and are four times higher than overall FDI (World Bank, 2020a).

Increasing private sector productivity would improve export competitiveness, increase job opportunities and allow for higher wages. This is particularly the case considering the increase in the average wage over the past decade partly resulting from growth in public sector wages. To regain labour cost competitiveness in export markets, productivity will need to increase more quickly.

Reform measure 6: "Improving the environment for doing business by reducing the administrative burden and reforming inspections" is rolled over from measure 9 in last year's ERP. It aims to reduce the administrative burden through simplification and digitalisation of permits as well as a reform of the inspection's regime. Activities are presented broadly and are repetitive over the years making it difficult to grasp the systematic progress envisaged. Overall, the activities and indicators presented fail to give an accurate overview of the scale of the administrative burden reduction and digitalisation effort making the measure difficult to assess.

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(39) The government projects a reduced current account deficit of 6.1% for 2022 off the back of significant increases in services' exports. Although this is at odds with IMF forecasts of 10.4%.

The government has adopted an improved Administrative Burden Reduction programme for the public and businesses and has increased the number of services provided on the E-Kosova platform from 21 in 2021 to around 140 in 2023. However, this progress is not mentioned in the ERP. The ERP also fails to mention significant financial assistance provided in this area from the EU's IPA instrument.

The indicators are difficult to assess as the method to measure progress has changed from last year's ERP. After several years of little progress, the indicators appear ambitious with a large reduction in the number of inspection bodies and a large increase in the number of simplified and digitalised permits. The activities and resources outlined under this measure appear insufficient to meet these targets.

5. Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2022

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye has adopted targeted policy guidance for all partners in the region. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the policy guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the policy guidance is evaluated by the Commission in the following year's ERP assessments. The following table accordingly presents the Commission's assessment of the implementation of the 2022 policy guidance jointly adopted by the EU and the Western Balkans and Türkiye at their Economic and Financial Dialogue at Ministerial level on 24 May 2022.

Overall: Partial implementation (45.8%)[40]	
2022 policy guidance (PG)	**Summary assessment**
PG 1:	There was **partial implementation** of PG 1.
If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; provided the economic recovery is well entrenched, and as envisaged by the ERP, target in the 2023 budget and medium-term expenditure framework a return to the 2% deficit ceiling of the fiscal rule.	1) **Substantial implementation.** In 2022, the government allocated and implemented around EUR 316 million (3.5% of GDP) in temporary support to vulnerable households, pension and salary bonuses and subsidies to the energy and agricultural sectors. The measures could have been better -targeted and more transparent, as some of them went beyond the target of vulnerable households, such as energy tariff subsidies for all consumers. The government ended 2022 with a roughly balanced budget driven by slower than anticipated implementation of capital projects and solid revenue performance. Using the available fiscal space, the authorities plan a strong fiscal stimulus, which is nonetheless in line with the envisaged compliance with the fiscal rule deficit ceiling of 2% of GDP in 2023.
Ensure proper costing of new pension and social policy initiatives and compliance with the legal ceiling applicable to the public wage bill and spending on war veteran pensions.	2) **Partial implementation.** While the Law on salaries of public officials, which came into force on 9 February, provides for an increase in salaries for most public employees, including specialist doctors, teachers and police officers, the value of the wage coefficient was set at the level of EUR 105 for 2023. In this way, the increase of around EUR 100 million (0.3% of GDP) in the public wage bill is lower than the nominal GDP growth in 2021, thus the wage bill rule was respected. The government has not achieved any concrete results so far in terms of reforming the social security system. The planned implementation of the reform of social assistance schemes through a World Bank loan and technical assistance has recently been passed by the Assembly. In relation to war veteran pensions, there has been no

(40) For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

	progress in re-classifying the beneficiaries list, and actual expenditure for this pension scheme exceeded the initial annual budget allocation, by around EUR 5 million in 2022.
Undertake and publish a review of tax expenditure quantifying the size of the revenue forgone from all exemptions and reduced rates.	3) **Limited implementation.** While a comprehensive tax expenditure report was not finalised, the government published in December 2022 a report summarising the main fiscal developments in 2021. The report provides a preliminary quantification of the size of the revenues forgone due to some of the tax exemptions and reduced rates in 2021.
PG 2: Improve the execution of capital spending by implementing the recommendations made under the IMF's Public Investment Management Assessment.	There was **limited implementation** of PG 2: 1) **Limited implementation.** The under-execution of capital expenditure remains a challenge for Kosovo, despite the authorities' efforts to improve it by implementing the PIMA recommendations. The execution rate was negatively affected by the COVID-19 pandemic and recent rising inflation. On average, only 60% of the annual budgeted capital expenditure (both central and local governments) has been executed since 2019. The authorities' continued efforts to improve the execution rate requires further attention especially when planning investment projects. Many of the projects do not undergo a proper appraisal and selection process as set out in the administrative instructions on project selection and the related public investment programme manual. These projects are therefore not ready for implementation when approved.
Improve the financial oversight and accountability of publicly owned enterprises (POEs) and continue regular quarterly reporting on all POEs.	2) **Partial implementation.** During the reporting period, the Ministry of Finance continued to include the fiscal risk analysis of main central POEs in the medium-term expenditure framework (MTEF), annual budget and the ERP. The fiscal risk analysis has been expanded beyond the POEs overseen by the Ministry of Economy to include the Kosovo Electricity, Transmission, Market and System Operator (KOSTT), which is overseen by the Assembly. However, the analysis is limited to high-risk POEs, excluding other companies. As of Q1-2022 a quarterly report on the financial situation of POEs is published on the Ministry of Finance's website with better data quality. A section on POEs' borrowing is also included in the quarterly debt report (in line with the requirements of the new Law on state debt adopted in December 2022). The Ministry has also started assessing fiscal risks on loans that are requested by POEs. In December 2022, the government approved the 2021 performance monitoring report on POEs prepared by the Ministry of Economy (in charge of supervising the central POEs). The report is pending Assembly approval and will then be published on the Ministry of Economy's website. The 2020 report was not approved by the Assembly. The government has not amended the Law on POEs and has not included it in the 2023 legislative programme. A working group will be set up to draft a new concept document and prepare a new law on POEs from scratch.
Review the options paper on the establishment of	3) **No implementation.** The government has not taken any steps to set up the independent body for fiscal

an independent body for fiscal oversight, so that the suggested options ensure operational independence and adequate budgetary safeguards.	oversight, following finalisation of the options paper on the matter.
PG 3: Carefully assess and analyse price developments, publish time series for core inflation and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Ensure that core areas of the central bank, including financial stability and banking supervision, are adequately staffed. Continue to ensure a transparent and accurate reporting of asset quality and adequate provisioning, further reduce remaining obstacles to NPL resolution and continue to reduce data gaps in particular as regards the real estate sector.	There was **partial implementation** of PG 3. 1) **Substantial implementation.** The central bank carefully monitored the evolution of price dynamics and started publishing a monthly series of core inflation. However, no macroprudential tools were used so far for instance to curb credit growth, and the concentration of fiscal spending on transfers also contributed to increasing demand. 2) **Partial implementation.** The central bank made progress in terms of staffing in core policy areas. In 2022, two additional employees were hired in the Financial Stability and Economic Analysis Department as well as in the Banking Supervision Department. Given the low starting level of staffing, as well as high turnover, additional recruitment seems to be still needed. In addition, proper and equal training opportunities need to be ensured to deepen analytical and technical skills of staff in the core policy areas. 3) **Partial implementation.** Asset quality is reported in line with International Financial Reporting Standards (IFRS9), the NPL ratio continued to stand at low levels, and provisioning remained adequate. The central bank approved the regulation on the liquidity coverage ratio in line with Basel III, which entered into force in January 2023. The central bank plans to change legislation to enable the development of a secondary market for NPLs. A new stand-alone commercial court has been established, which might increase the efficiency of the court system but still faces a large backlog of cases. Significant data gaps, in particular as regards the real estate sector remained.
PG 4: Adopt a coherent long-term energy and climate strategy for lowering carbon emissions, including plans for a phase-out of coal and fossil fuels subsidies as committed under the Sofia Declaration. In line with the commitments of the Green Agenda for the Western Balkans: increase energy efficiency incentives for the private sector and households and improve the support schemes for renewable energy projects with the introduction of competitive bidding/auctions Adopt an action plan for the gradual adjustment of energy tariffs reflecting actual costs and providing mitigation measures for vulnerable consumers, and implement the plan to liberalise the retail energy market.	There was **partial implementation** of PG 4. 1) **Partial implementation**. The new 10-year national energy strategy is finalised and was approved by both government and the Assembly Energy strategy does not cover all sectors of the economy. A long-term decarbonisation strategy is planned but not yet drafted. 2) **Partial implementation**. The Energy Efficiency Fund continued to support improvements in energy efficiency of public buildings and plans to extend financing to the private and residential sector are ongoing. The Law on renewable energy sources is finalised and its approval by the government is expected soon. Competitive auctions for renewable energies planned for 2022 have been delayed. 3) **Limited implementation**. The Energy Regulatory Office (ERO) announced new electricity tariffs which entered into force in February 2022 following an extraordinary review of tariffs in light of rising energy costs in 2021 and 2022. Prices remained the same for households consuming up to 800 kWh (approximately 78% of households) and increased for those consuming more than this. There were no changes for business

	operators. In February 2023, the ERO announced a further increase in of 14%. There is currently no action plan for the gradual adjustment of energy tariffs to reflect actual costs. The government committed EUR 90 million to subsidise energy costs for regulated tariff customers.
PG 5: Update the action plan of the 2019–2023 National Strategy for the Prevention and Combating of Informal Economy, Money Laundering, Terrorist Financing and Financial Crimes, and ensure its implementation. Improve the business environment through measures to simplify, merge, abolish and digitise licenses and permits with an aim to reduce the barriers to formalisation of employment and businesses and continue to address tax evasion in identified high-risk sectors in line with the strategy and the action plan, which should be updated based on sector risk assessments and tax gap analysis. With an aim to prevent evasion of property income tax, improve transparency by publishing all sales prices of real estate property.	There was **partial implementation** of PG 5: 1) **Substantial implementation.** The government adopted the updated action plan for 2022 and 2023 of the strategy on preventing and combating the informal economy and has published a 6 monthly report on implementation of the strategy covering the first half of 2022. Nevertheless, authorities need to enhance the efforts on implementation of the strategy and its action plan considering that only 50% of the foreseen actions were implemented as highlighted in the monitoring report. 2) **Partial implementation.** The government adopted in September an improved programme for the reduction and prevention of the administrative burden of citizens and businesses. At the same time, the e-Kosova platform has increased the number of services that are available through the platform from 21 in 2021 to 140 today. The application of grants and subsidies for the agricultural sector has recently been put up on the platform, for example. The government has also published in the Official gazette secondary legislation making transparent the required documentation for the approval of permits and licences. 3) **No implementation.** No sales prices of real estate property have been published so far.
PG 6: Thoroughly apply existing quality assurance mechanisms at all levels of education through increased school inspections, including training of inspectors, and effectiveness of quality coordinators, as well as monitoring and follow up procedures of higher education institutions and their study programmes by the Accreditation Agency. Narrow the skills mismatch gap by upgrading and using existing skills needs monitoring and forecast mechanisms as well as by increased cooperation with social partners and businesses for an informed planning of initial and continuous vocational education and training, curriculum development and adequate active labour market measures.	There was **partial implementation** of PG 6: 1) **Partial implementation.** As regards basic education, besides initiatives to amend legislation, there is little evidence of progress. The government increased budgetary allocations to hire an additional 30 education inspectors; however, due to problems with the law on public officials, it is not realistic to expect recruitments to happen this year. The number of inspections of teaching staff and schools remains very low. The situation is better in higher education. The Accreditation Agency has slightly increased their number of staff. Thanks to the digital platform, the agency has managed to complete accreditation processes smoothly and in a timely fashion and also carry out more post-accreditation monitoring. 2) **Partial implementation.** There are positive developments but still mainly driven by donors. Crucial data and studies are not available yet to first provide an evidence-based baseline - quality data are needed. The Education Strategy 2022-2026 fully recognises the need to develop a real-time information system on labour market needs and to develop a methodology for standardized methodology for labour market research and forecasting the labour market needs. This commitment has yet to be translated into action. Recent achievements include Kosovo Generation Unlimited (K-GenU) and Superpuna which brings together government institutions, development partners, private sector actors, civil society

	organizations and young people. These partnerships aim to empowers and engages young people by connecting them with opportunities to improve their transition from school to work through skills development, mentorship, internship or employment. Nevertheless,priority should be given though to longer term and sustainable solutions such as the Youth Guarantee (preparation ongoing).
Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation.	3) **Substantial implementation.** The youth guarantee implementation plan was adopted, legislative changes are planned and there are ongoing reforms in the Employment Agency.

ANNEX A: ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE ERP 2023-2025

Public financial management

Including a specific measure on public financial management reform in this year's ERP is welcome. The ERP highlights a number of key areas where Kosovo has made progress including the finalisation of a new law on public procurement and the publishing of fiscal risk assessments. Unfortunately, the ERP does not analyse or provide an overview of the main obstacles facing Kosovo in this area. The specific reform measure relating to the digitalisation of the Ministry of Finance is a good step forward. Reform of public financial management should be built on in future ERPs, and the link between the activities and broader challenges and priorities should be made clearer.

Specifically, public financial management systems should be strengthened by (i) linking strategic policy and budget planning for sectoral policy priorities and credibly reflecting these in the medium-term expenditure framework; (ii) improving the public investment management system along Public Investment Management Assessment (PIMA) recommendations, while making the Public Procurement Review body functional and integrating the module on green investments; (iii) improving the domestic revenue mobilisation by aligning the current tax policy with international standards to combat informal economy; (iv) developing capacities to conduct spending reviews and to ensure that findings inform budgeting, in order to support expenditure prioritisation and create fiscal space for new priorities (i.e. improving social services and green transition).

The ERP notes that broader public financial management challenges and priorities will be addressed comprehensively in the soon to be adopted Public Financial Management Strategy 2022-2026.

Reform measure #8: *"Restructuring and consolidation of all IT system resources in support and development of public finance management"*. This is a new measure which aims to integrate systems and services of agencies and departments within Ministry of Finance to align the budget with policy priorities, improve tax compliance and deliver services more effectively.

The measure appears to be well thought out, precisely costed and contains a number of detailed and ambitious indicators. The activities in this measure relate only to the Ministry of finance. This will help with implementation and ownership of the process, but it does create the risk of a piecemeal approach to digitalise government services. Greater alignment with reform measures 6 and 7 would be preferable.

Green transition

The parts of this sector related to energy market reform, energy efficiency and renewable energy are analysed in Section 4 above, under key challenge #1.

Kosovo continues to face numerous environmental challenges such as climate change and air, water, waste and soil pollution. The country has some of the worst air pollution in Europe, with an annual mean exposure to particulate matter almost three times the World Health Organization recommended highest levels. The ERP acknowledges this situation and its causes (reliance on coal power plants, emissions from the transport sector, etc.) and describes the air quality monitoring system currently in places. However, no further significant measures are proposed to tackle air pollution. Kosovo is generally lagging behind in the implementation of the Green Agenda for the Western Balkans; the budget foreseen for the environment sector for 2023 is very limited (EUR 5 million). The ERP analysis focuses primarily on recycling, biodiversity and wastewater treatment.

Reform measure 9: Reducing environmental pollution and preserving biodiversity is rolled over from measure 7 in last year's ERP. The proposed activities under this measure are only partial and are insufficient comparing to the existing problems. The majority of the activities concern legislative or strategic planning measures, while the concrete implementation measures are not clearly described. The foreseen implementation activities in the waste management sector include only the introduction of some recycling for some waste streams, but the introduction of the system for integrated waste management is not described. However, the drafting and adoption of a long-term decarbonisation strategy is welcome.

Indicators are detailed and ambitious but provide for little progress initially and dramatic improvements in later years. This does not appear credible or justified based on the activities planned and resources available. The establishment of a deposit refund system for glass, plastic bottles and cans is welcome but not credible. The targets to increase the number of protected nature areas does not address the problem highlighted in the diagnostic part that the management of existing nature areas is still ineffective. Continuous damage to forests from illegal logging is identified as a high-risk factor but little is planned to mitigate this risk.

Digital transformation

The digitalisation of the economy is advancing. 100% of households nationwide now have access to fixed broadband electronic communications infrastructure. On building a gigabite digital infrastructure, there are bottlenecks in the backbone infrastructure and insufficient capacity for international connections. Fixed access internet penetration is estimated to be 125% of households compared to 89%[41] in the EU and mobile telephony penetration is around 95% of the population. An estimated 78% of the population have access to 3G and 4G networks compared to 100% in the EU. The Economic and Investment Plan for the Western Balkans will continue to support investments in digital infrastructure to deploy ultra-fast and secure broadband to ensure universal access. Kosovo has a small but rapidly growing ICT sector with around 17 000 employees and exporting IT services amounting to around EUR 100m in 2021. Exported IT services include software development, smart phone application development and web design. The industry appears to show some resistance to the brain drain phenomenon as more than half of the companies (61.29%) have had a turnover rate of less than 10% (STIKK, 2021).

(41) https://ec.europa.eu/eurostat/documents/3888793/14209569/KS-TC-21-008-EN-N.pdf/99f04bbe-235d-35f7-4f1c-890a04d8e09e

Kosovo has been engaged constructively in high-level regional dialogue on digital transformation and the implementation of Regional Roaming Agreement since 1 July 2021. Kosovo hosted the Western Balkans Digital Summit in Pristina in September 2022. While progress in digitalisation among SMEs, the overall uptake of e-commerce has decreased. A regional survey found that only 17% of Kosovar companies used the Internet to sell their goods and services in 2021, compared to 30% in 2019. Thus, despite some improvements in implementing e-commerce programmes, there seems to be little progress in increasing the adoption of e-commerce practices among SMEs (OECD, 2022). Kosovo needs to continue to develop the legal framework and necessary infrastructure to stimulate e-commerce and allow for international electronic payments. According to the latest OECD SME Policy Index (OECD, 2022), the rollout of e-governance services is still at an early stage and going forward, Kosovo should adopt a comprehensive policy framework for digital transformation and ensure horizontal co-ordination of digital service delivery. On cybersecurity, Kosovo is improving its legislation to ensure the security of network and information systems; however, it should step up the implementation of relevant measures in this field, particularly by allocating the necessary financial and human resources.

Reform measure 10: "Extension of ICT infrastructure and services for socio-economic development, advanced public services, as well as digitalisation of the education system" The measure to extend ICT infrastructure is rolled over from last year's ERP and revised to include different policy actions. The measure is comprehensive, well planned and substantial progress is possible if described activities are implemented. Challenges facing the sector are well identified and opportunities and ways forward are highlighted. Indicators are detailed and credible. In terms of budgeting, the implementation is planned through a combination of national and IPA funds.

Business environment and reducing the informal economy

This sector and the reform measures 6 and 7 are analysed in Section 4 above, under key challenge #3.

Research and innovation (R&I)

Kosovo's performance is still very poor in research and innovation (policy governance, public research system, public-private linkages, innovation in firms and human resources for innovation); the country has one of the lowest scores in the Western Balkans region[42]. The sector suffers from a chronic fragmentation in implementing innovation policy and no overall coordination among line ministries and the SME agency KIESA. Financial support for research and development is also very limited (less than 0.1% of GDP compared to an average of 2.2% in the EU), particularly for business innovation. Over the past year however some positive developments took place that might pave the way for a new dynamic in the sector. The authorities appointed a National Scientific Council in 2021, which by law is in charge of drafting the national research programme. Kosovo has successfully completed negotiation with EU and is now a fully associated member of the Horizon Europe programme, although it needs to improve its performance in accessing grants. Efforts are under way to develop the Kosovo Research Information System and make it operational. In the Government Programme 2021 – 2025, Kosovo has planning to set up an "Innovation and Entrepreneurship Fund", to collect innovation-related statistical data, and application to participate in the European Innovation Scoreboard. Work on preparing a Smart Specialisation Strategy has commenced in 2019 in line with the methodology of the EC's Joint Research

(42) OECD (2021), *Competitiveness in Southeast Europe – a policy outlook 2021*.

Centre. Although it completed an analysis of identifying scientific priorities and a communication mechanism to enable stakeholder consultation has been put in place, a more systemic involvement of stakeholders (industry, academia) is needed.

Reform measure 11: "Improving the environment for research, innovation and entrepreneurship"

Since the previous ERP, Kosovo has improved the activities under this measure and taken on board feedback from the previous ERP assessment and other policy dialogue fora. There are a number of positive activities for which a greater of focus on outcomes would be welcome, for example the aim to join the European Scoreboard and the establishment of a National Innovation Fund. In general, there is a need to explain how certain funding measures are complementary to ongoing support from the EU and other international partners such as the EBRD, for instance support to businesses and incubators. This component should provide resources such as trainings, business consulting services and mentorship that are essential to the success of start-ups and idea generation. There were no activities related to support for or focus on young entrepreneurs or partnerships with relevant stakeholders including industry, the diaspora, the NGO sector, etc. As in previous years, key indicators for the R&D sector and the benefits of innovation processes are lacking. The envisaged financial support appears adequate for the activities targeted and is entirely funded from the national budget but is still far below the required 0.7% of GDP stipulated by law (at 0.1%). There is no mention of how Kosovo will make the most of its new Horizon 2020 membership, nor reference to the research data (data on researchers, publications, funding per Higher Education Institute spent on R&I, research infrastructure) currently being conducted by the Erasmus+ Kosovo Research Information System (KRIS) project, led by the International Business College - Mitrovica in cooperation with the Austrian Development Agency. Lack of data is a challenge in Kosovo, and this is the first such whole-scale initiative to aim to tackle it.

Economic integration reforms

Kosovo is highly reliant on imports and suffers from a chronically current account deficit (8.7% in 2021 and an estimated 6.1% in 2022)[43]. Despite the fall in exports of base metals due to higher energy prices, the export of goods has increased in 2022 due to improved exports of furniture, plastic and rubber products. The balance of services has also improved due to higher tourism spending (mostly diaspora related). Trade with the EU and the Central European Free Trade Agreement (CEFTA) region represents almost the totality of trade exchanges. Due to higher growth of exports than imports over the last 10 years, Kosovo has experienced an improved export coverage ratio with the region, from 9.1% in 2008 to 20.3% in 2019. The CEFTA area has remained the main destination for the export of goods, amounting to 276.7 million EUR or 36.9% of total exports. The opposite trend is observed in trade between Kosovo and the EU. Kosovo's goods exports to EU Member States amounted to 235.1 million EUR, about 31.3% of total exports in 2021. CEFTA remains an important market for Kosovo exporters, but obstacles and barriers to trade persist.

Major progress was made with the opening of Customs Office at the Port of Durrës in Albania and the conclusion of the Berlin Process Agreements Customs clearance for all goods with a final destination of Kosovo will now be cleared directly on arrival at the port of Durrës, thus eliminating the need for further checks on entry into Kosovo. This step toward regional economic integration has led to a substantial reduction of costs for business and a

(43) Kosovo authorities project a narrowing of the current account deficit to 6.1% of GDP in 2022 off the back of strong increases in the export of services. This is at odds with IMF projections of 10.4% in 2022.

more timely delivery of goods. The authorities have fully ratified the "Berlin Process Agreements" on free movement of people, and mutual recognition of academic and certain professional qualifications. Once fully operational, these agreements will further boost economic integration in the region.

Kosovo is encouraged to implement all aspects of the Common Regional Market as set out in the Economic and Investment Plan for the Western Balkans. The Common Regional Market will facilitate Kosovo's integration into regional and European value chains and help make the economy more attractive for foreign direct investment in tradeable sectors, notably by extending the size of the market. Further connectivity with neighbouring countries in transport and energy will strengthen access to, and integration into, the regional market. The ratification of CEFTA's additional protocols 5 and 6 will help liberalise trade in goods and services and will also create new export opportunities in the dynamic service sectors; it should therefore be implemented swiftly. The creation of a regional digital space and labour markets that are more integrated with neighbouring economies will offer new prospects for young people in Kosovo, which is also important given the high rate of youth unemployment.

Despite being among the most open economies, foreign direct investment (FDI) in Kosovo remains limited (averaging slightly over 4.0% of GDP in 2013-2021), and mainly comes from the large Kosovo diaspora. By year end 2021, FDI amounted to EUR 320 million, which was 11.8% higher than 2019. The sectoral distribution of FDI remains dominated by non-productive sectors, namely real estate and construction, which have a limited impact on the efficiency of Kosovo firms. There is potential to attract more FDI: Kosovo has a good strategic location, a young population and relatively low labour costs, and a growing educated workforce with increasing ICT and foreign language skills. Other key issues affecting FDI are the lack of basic infrastructure and stable electricity supply, poor education skills, weak rule of law, corruption and the slowdown in the privatisation process. The measures planned under this area address these challenges.

Reform measure 12: "Improving business environment through trade facilitation and quality infrastructure development". This measured rolls over and combines last year's measures 12 and 13 and aims to address both regional economic integration and improved product standards and certification. The ratification of additional protocols 6 and 7 of CEFTA has long been stalled by the government due to disputes over recognition. Ratification of protocol 6 does not appear among the activities while ratification of protocol 7 appears under 2024. Some activities under this measure, related to CEFTA or WTO membership negotiations, carry political risk and are dependent on external factors. The activity relating to making free public customs terminals functional is welcome, but it is unclear if this activity has been costed. In terms market surveillance, Kosovo has allocated a substantial budget of over EUR 6 million for certification of industrial products with the aim of increasing exports. The funding is to be allocated from the government funds. Indicators for the measure are realistic but could be more ambitious.

Energy market reforms

This sector and the reform measures 1 and 2 are analysed in Section 4 above, under key challenge #1.

Transport market reforms

Transport links are less of a constraint to Kosovo's competitiveness than issues in other sectors, but improving connectivity with neighbouring countries would strengthen the country's integration into the regional market. Investments have been primarily focused on road infrastructure rather than other modes of transport, without the right allocation of resources to road and railway networks maintenance and with an increasing amount of capital investment directed to prestige projects without clear transport, environmental or development rationale. On rail, the continuing works on Route 10 linking southern and northern Kosovo, the Serbian border and Pristina with the capital of North Macedonia represents the biggest investment in Kosovo's railway in four decades (around EUR 200 million) and is poised to improve Kosovo's railway network and its connections to the wider European network both for passengers and freight. However, a much more ambitious plan, including maintenance and integration with European networks, as well as an upgrade of the legislative framework to align it with the EU *acquis*, to improve the efficiency of Kosovo's railway networks. Regarding aviation, status issues, including a lack of revenue from upper air space management, continue to constrain Kosovo's ability to invest in training, infrastructure and safety. The flagship policy of the Economic and Investment Plan will be the finalisation of the 'Peace Highway' in Kosovo, directly linking Pristina with Niš in Serbia and thus helping to overcome the transport-related constraints on Kosovo's economy.

Reform measure 13: "Further development and modernisation of transport". This measure was introduced for the first time in last year's ERP and has been rolled over to this year. It covers some of the main actions to reform the transport sector. The activities are ambitious, comprehensive and include the adoption and implementation of transport-related legislation, drafting and adoption of sectorial strategies and alignment with the EU *acquis*. The measure also covers the rehabilitation and modernisation of major railway lines and construction of roads. It is encouraging that the government plans awareness campaigns and the drafting of the national programme to improve road safety. The lack of proper maintenance plans is the main reason for slow and unreliable transport services. The measure does not include the development of a multiannual maintenance plan underpinned by sufficient financial resources. The indicators for the measure have been much improved upon since last year, and the inclusion of an indicator on emissions is welcome; however, an indicator on road safety has been removed.

Agriculture

Kosovo's agriculture sector is beset by low productivity and high production costs. Although it remains relatively large, the sector's share of gross value added continues to fall, (it accounts for a significant share of informal employment). Farmers in Kosovo are faced with several constraints, such as high numbers of small farms and high levels of land fragmentation, outdated farm technologies, lack of production diversification, limited capacity to grow and limited technical support and access to finance[44]. Less than a fifth of Kosovo's arable land is irrigated. Although the government has developed some to address some of these issues (e.g. irrigation systems and organic farming), further investment and action are needed to ensure the measures are implemented and boost the competitiveness of the agricultural sector. Existing support schemes, currently under review, would benefit from a broader approach to developing value chains and integrating them into export markets, instead of direct subsidies for agricultural production and food processing facilities. Other neglected issues are the protection of agricultural land, the environment and less favoured areas (hillsides, rolling land, etc.) that have lower productivity. The Economic and Investment Plan for the Western Balkans has the potential to mobilise much support for the sustainable transformation of Kosovo's agri-food system and rural development.

([44]) Approximately 93.03% of agricultural holdings, or 100 576, belong to farm size categories of less than 5 ha. (Ministry of Agriculture, Forestry and Rural Development, 2019).

Kosovo has potential to develop freshwater fish farming and aquaculture. This sector has a potential for a sustainable food production, new job creation, attraction of foreign direct investment and export to the EU and other markets.

Reform measure 14: "Structural changes in the agriculture sector"

The activities outlined under this reform measure focus mainly on implementation of existing support for farmers, investments in irrigation infrastructure and drafting different pieces of legislation. Given the fact that agriculture is considered to be a key sector, the measure fails to address a number of structural obstacles that hinder the development of the sector, such as poor land consolidation, small average farm sizes, land loss to unplanned urban expansion, low productivity and high production costs, low product diversification, outdated technology, limited storage capacity, weak or dysfunctional links between primary producer and processor and between producers and market as well as lack of specialisation. Although Kosovo rightly prioritises irrigation, (a feasibility study and work to implement it are listed as activities in 2023), the credibility of this action is questionable without accompanying measures to improve water quality. There is no mention of EU support under IPA (for example, a EUR 10 million project for irrigation under IPA 2020 managed by the World Bank is not referenced).

Industry

Kosovo's industry is characterised by low added-value and competitiveness. The sector makes a modest contribution to GDP (around 26% in 2021) and employment (around 14%). Manufacturing is dominated by food processing and non-metallic mineral products, accounting for 70.3% of all exports (with metals and rubber and plastics products accounting for 42% of the total). Although manufacturing has the potential to generate quality jobs and raise incomes, high-level and sustained industrial development continues to face structural problems. The sector is dominated by micro, small and medium-sized enterprises with low levels of integration in global value chains, and low shares of innovation. They also attract low levels of foreign direct investment..

Inter-ministerial coordination in this policy area is weak and the responsible institutions (such as the Kosovo Investment and Enterprise Support Agency, KIESA) lack the capacity to implement plans (OECD, 2021). However, KIESA's performance has improved recently with the organisation of and participation in economic fora and international trade fairs as well as improved direct support for investors. There has been a strong increase in FDI a in 2022 (ca. 6% of GDP). A number of business parks and economic zones have been identified and are promoted as industrial clusters, but most are currently under-utilised and under-funded. Poor cooperation between companies and educational and research institutions and the generally low level of skills in the labour force lead to low production capacities and a lack of product quality and innovation. The government will soon adopt a Strategy for Industrial Development and Business Support containing specific and measurable industrial policy objectives. The strategy is based on an industrial performance analysis, which assessed the economic, social, and environmental performance of Kosovo's manufacturing sector over the past 10 years. The government is preparing new legislation on investment promotion and industrial and business parks. It also plans to restructure KIESA into two separate agencies: an SME and entrepreneurship agency and an investment and export promotion agency. These measures need resources and quality staffing to succeed.

The Economic and Investment Plan, which has productive investments based on circular economy principles at its core, could significantly bolster Kosovar industry's sustainable production and consumption.

Measure 15: "Increasing competitiveness in the production industry"

This measure is rolled over from previous years and focusses on supporting SMEs, improving quality standards and growing foreign direct investment. The planned restructuring of KIESA is welcome although it is not mentioned as one of the activities under this measure and neither is the associated law on sustainable investments. Beyond the restructuring, further action is needed on resources and capacity building to ensure the agency can fulfil its objectives and promote linkages between SMEs and multinationals.

As in previous years, this measure contains a number of direct support measures for businesses to boost production and exports. KIESA support programmes to SMEs should also encourage gender balance and women entrepreneurship. This support should focus on businesses and sectors identified as priorities in the new Industrial strategy. The construction and development of economic zones and industrial parks is included as an activity again, and the budget is similar to last year's ERP. The government also plans legislation to improve the functioning of new and existing industrial parks. However, there is still no feasibility study on industrial zones assessing their return on investment and contribution to economic development. Building these industrial parks should be based on clear and objective criteria and avoid conflicts with state aid legislation.

Services

Despite being the driving force of the economy, Kosovo's services sector suffers from a lack of competitiveness and relies heavily on non-tradeable services. With a share of 72.7% of GDP in 2020 and 79.1% of total formal employment, this sector constitutes the backbone of the private sector. It is mainly composed of non-tradeable activities (accounting for more than two thirds of all sector turnover). Trade in services has been dynamic in recent years, reflected in a sustained service trade surplus, and it has made a significant contribution to Kosovo's current account, driven primarily by the travel and hospitality industries. The export of travel services reached EUR 1.5 billion in 2021 representing 79% of all service exports in 2021. However, most of the travel services provided were for visits by the Kosovo diaspora, which raises concerns as to its long-term growth potential.

ICT services are a promising and rapidly growing sector. Exports of ICT services amounted to around EUR 100 million in 2021 but only make up 5% of total service exports. The development of a competitive tradeable services sector is being held back by an unfavourable business environment, a lack of quality infrastructure and poor access to technology and finance for firms, especially SMEs.

Measure 16: "Increase competitiveness in the sector of trade in services"

The measure is rolled over from last year's ERP and aims to improve the efficiency and competitiveness of tradeable services. The activities planned annually for 2022, 2023 and 2024 are realistic and the sequencing is sound. The single point of contact has already been launched on the e-Kosova portal. It will be important to further develop the single point of contact and integrate additional services. While the funding appears sufficient, it may not be enough if more intensive software development is required. As with other aspects of trade policy, some activities e.g. those related to CEFTA, carry additional political risk and are dependent on external factors. Activities on implementing of the CEFTA additional protocol 6 on trade in services are welcome. However, the lack of human resources in the Ministry of Industry Enterprise and Trade is correctly identified as a high risk to successfully implement these activities.

Measure 17: “Increasing competitiveness in the tourism and hospitality sector”

This measure to develop tourism products in Kosovo's touristic regions has been rolled over from last year’s ERP. It is still not sufficiently ambitious to have a significant impact on the economy. The reform of the sector would also require a dedicated strategy and concrete action plan with allocated resources, a timeframe, and ownership. The measure fails to integrate or leverage existing cultural events and festivals. It does consider the impact on the environment and the need for interinstitutional cooperation to alleviate that impact. However, just as last year, it still fails to include other relevant actions, such as abolishing illegal landfills and cleaning waste across the territory, which is a precondition for attracting tourists. The costing of the measure is not properly assessed and does not factor in donor funding including from IPA, such as a EUR 2 million contribution to improving tourist infrastructure in Prizren or a EUR 2 million contribution to a project in Janjevë/Janjevo.

Education and skills

This sector and the reform measures 3 and 4 are analysed in Section 4 above, under key challenge #2.

Employment and the labour market

This sector and the relevant reform measure 5 are analysed in Section 4 above, under key challenge #2.

Social dialogue

Kosovo has yet to tap the potential of social dialogue. The reduction in the high level of informal work in the labour market may improve the ability of workers to exercise their rights. It could also have a positive effect on social dialogue. However, the structure of the labour market hampers the development of fair relationships between employers and employees. A number of business confederations mostly represent the interests of larger employers, while over 90% of registered companies are micro-enterprises with fewer than 10 employees. Although the legal framework is in place, there is little political will to use social dialogue when drafting policies and legislation. The capacity of social partners, in particular trade unions, to influence policy remains limited. A protracted conflict over the composition of the Economic and Social Council is to be solved by amending the law governing the Council, but there is still progress to be made.

Social protection and inclusion

Kosovo’s social protection system is not targeted or effective as many households in need remain outside the scheme. Unlike most European countries, the social assistance scheme is financed by state revenue (mainly VAT and direct taxation). However, the scheme is ineffective and unbalanced as most of the revenue goes to pensions, including pensions for war veterans, and war-related schemes. Consequently, very little goes to social services and to labour market policies. As underlined in the World Bank’s social protection situational analyses, the system is unsuitable for the country’s poverty profile (World Bank, 2022b). In addition, links between the social assistance scheme and social care and employment services are weak or non-existent. This leads to cases being managed in a fragmented manner.

Only about 7% of the total population benefits from the current scheme although the official national poverty rate is closer to 20%. The poverty rate fell significantly in 2021 but is expected to have only decreased marginally in 2022. Continued inflationary pressures could also lead to the poverty rate stagnating (World Bank, 2022a). The situation is particularly bad for minority communities. Higher commodity prices and the energy crisis are expected to increase poverty in Kosovo even more. Therefore, there is a clear need to reform Kosovo's social assistance scheme. The eligibility criteria under the current system are very strict, and this leads to making many poor households ineligible for support.

The government has adopted the reform, and the Assembly recently ratified a World Bank loan (which will fund the reform). The revised design proposes to select beneficiary households based on their poverty status by only considering formal and informal income. This should make the system significantly fairer and better reflect the country's poverty profile. The reform will also create a legal basis to expand the scheme's coverage when poverty dynamics in the country change and more budget is available to finance poverty-targeted programmes. Recent experience also shows the need to invest in how the scheme is delivered, including an integrated data management system (social benefits information is currently housed in multiple management information systems, and there is no social registry).

The reform will depend on parallel reforms of activation measures and better coordination between the social assistance system, care services and employment services, particularly to encourage beneficiaries to participate in reskilling and upskilling to improve their job search efforts. The effective implementation of the youth guarantee depends on the integration of these services. Payment systems must also be modernised to increase transparency and accountability. These reforms are a critical first step to ensuring that the country's vulnerable groups are protected today and in the future.

Measure 19: Improving social services and empowering excluded groups

The measure aims to create a sustainable social protection system that meet the needs of the population, in particular the most vulnerable. It also aims to deliver integrated and targeted social services. A number of laws and bylaws need to be passed before implementation is expected to start in 2024. In addition, the government will continue to support licensed NGOs with grants and subsidies as they have a significant role and involvement in the development and implementation of social policies and services.

Healthcare

The COVID-19 pandemic has put the health system under the spotlight. About 30% of the population living below the poverty line do not have access to healthcare. Health services require out-of-pocket payments, and this significantly affects the budget of low-income households. Essential necessary primary healthcare is unaffordable due to the lack of health insurance risk-pooling. Kosovo's healthcare system is funded by government revenue, which is scarce. The difficulty of access to care is reflected in the infant mortality rate which is about three times the EU average. Among Roma, Ashkali and Egyptian communities, the rate is three times higher than the national rate.

The law on health insurance (2014) gives everyone the right to carry mandatory health insurance. Following that law, the government adopted a national health sector strategy for 2017-2021. The strategy focused on providing better financing and better access for vulnerable people by strengthening primary care. However, the law has not been implemented yet. According to a recent note by the US Department of Commerce, the growing demand for quality healthcare and the lack of government resources to meet these needs create opportunities for US companies to provide many health-related services, including basic and specialised treatments, hospitals, clinics, emergency medical treatment facilities, and high-quality medicines and pharmaceutical products. This note also stresses that the public procurement process in the health sector is complex, time-consuming, and lacks transparency. In 2018, Kosovo allocated 4.6% of GDP to health. This rose to 6.8% in 2020 as a result of donations and loans for the COVID-19 pandemic, but this rate remains below that of other countries in the region. Therefore Kosovo must embrace the implementation of universal health coverage that offers equal access to everyone regardless of their financial situation.

Measure 20: Ensuring sustainable financing in the health system

This measure is carried over from previous years as the implementation was delayed due the COVID-19 pandemic. It will require changing the legal framework and extending/completing the health information system. The full implementation, planned for 2025, should ensure equal access to healthcare. Setting up a national health insurance scheme will then be financed by contributions from all public-sector employees and 65% of private-sector employees. According to the authorities, collecting these contributions is still a challenge. Vulnerable groups will be exempted from paying a contribution.

ANNEX B: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY

Area/Sector	2016	2017	2018	2019	2020	EU-27 Average (2020 or most recent year)
Energy						
Energy imports dependency (%)	23.6%	30.0%	29.3%	30.5%	29.5%	55.6%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	451.30	409.03	398.07	392.34	413.88	110.35
Share of renewable energy sources (RES) in final energy consumption (%)	24.47%	23.08%	24.62%	24.22%	24.40%	21.7%
Transport						
Railway Network Density (meters of line per km^2 of land area)	30.5[w]	30.5[w]	30.5[w]	30.5[w]	30.5[w]	N/A
Motorization rate (Passenger cars per 1000 inhabitants)	144.0[w]	154.6[w]	157.2[w]	162.0[w]	164.4[w]	N/A
Agriculture						
Share of gross value added (Agriculture, Forestry and Fishing)	10.2%	9.2%	8.1%	9.0%	8.9%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	4.2%[w]	4.4%[w]	3.5%[w]	5.2%[w]	4.8%[w]	4.3% (2020)
Utilised agricultural area (% of total land area)	38.2%[w]	38.2%[w]	38.5%[w]	38.6%[w]	38.6%[w]	40.6% (2020)
Industry						
Share of gross value added	24.3%	24.1%	24.2%	23.4%	24.1	19.9%
Contribution to employment (% of total employment)	18.0%[w]	17.4%[w]	14.3%[w]	15.1%[w]	16.3%[w]	16.1% %

Services						
Share of gross value added	56.4%	56.5%	57.2%	57.6%	57.7%	79.2%
Contribution to employment (% of total employment)	66.3% [w]	65.3% [w]	70.3% [w]	67.1% [w]	67.9% [w]	70.9%
Research, Development and Innovation						
R&D intensity of GDP (R&D expenditure as % of GDP)	N/A	N/A	N/A	N/A	N/A	2.26%
R&D expenditure – EUR per inhabitant	N/A	N/A	N/A	N/A	N/A	EUR EUR 734,5
Digital Economy						
Percentage of households who have internet access at home	N/A	89%	93%	93%	96%	92.5% (2022
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	N/A	82.9% [w]	87.7% [w]	90.7% [w]	96% [w]	90% (2022)
Trade						
Export of goods and services (as % of GDP)	23.8%	27.3%	29.1%	29.3%	21.7%	46.7%
Import of goods and services (as % of GDP)	51.2%	53.1%	57.3%	56.4%	53.9%	42.9%
Trade balance (as % of GDP)	-41.1%	-42.0%	-44.7%	-44.1%	-41.7%	N/A

Education and Skills						
Early leavers from education and training (% of population aged 18-24)	12.7% w	12.2% w	9.6% w	8.2% w	7.8% w	9.9%
Young people neither in employment nor in education and training (NEET) (% of population aged 15-29)	37.5% w	35.1% w	37.4% w	40.0% w	40.4% w	13.7%
Children aged less than 3 years formal child care (% of under 3-years-olds)	N/A	N/A	N/A	N/A	N/A	35.3% (2019)
Individuals who have basic or above basic overall digital skills (% of population 16-74)	N/A	21%	N/A	28%	N/A	56%(2019)
Employment and Labour Market						
Employment Rate (% of population aged 20-64)	32.3% w	34.4% w	33.2% w	34.2% w	32.3% w	71.7%
Unemployment rate (% of labour force aged 15-74)	N/A	N/A	29.4% w	25.5% w	25.8% w	7.1%
Long term unemployment rate (% of labour force aged 15-74)	N/A	N/A	N/A	N/A	N/A	2.5%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	35.3 pps.	39.4 pps.	38.5 pps.	37.4 pps.	32.8 pps.	11.0 pps.
Disability employment gap (Percentage points difference in employment rates between people with and without a disability)	N/A	N/A	19.7 pps.	N/A	N/A	24.5 pps.
Real gross disposable income of households (Per capita increase, Index = 2008)	N/A	N/A	N/A	N/A	N/A	107.23
Social Protection System						
At-risk-of-poverty or social exclusion rate (AROPE) (% of population)	N/A	N/A	56.7%	N/A	N/A	21.9%
At-risk-of-poverty or social exclusion rate	N/A	N/A	N/A	N/A	N/A	24.2%

of children (% of population 0-17)						
Impact of social transfers (other than pensions) on poverty reduction	N/A	N/A	5.42%	N/A	N/A	32.68%
Income inequality - quintile share ratio (S80/S20) (Comparison ratio of total income received by the 20% of the population with the highest income to that received by the 20% with the lowest income)	N/A	N/A	15.58	N/A	N/A	5.24
Housing cost overburden (% of population)	N/A	N/A	11.3%	N/A	N/A	9.9%
Healthcare						
Self-reported unmet need for medical care (of people over 16)	N/A	N/A	9.7%	N/A	N/A	1.8%
Out-of-pocket expenditure on healthcare (% of total health expenditure)	N/A	N/A	40.5% [z]	N/A	N/A	15.57% [(2018)]

w: data supplied by and under the responsibility of the national statistical authority and published on an "as is" basis and without any assurance as regards their quality and adherence to EU statistical methodology.

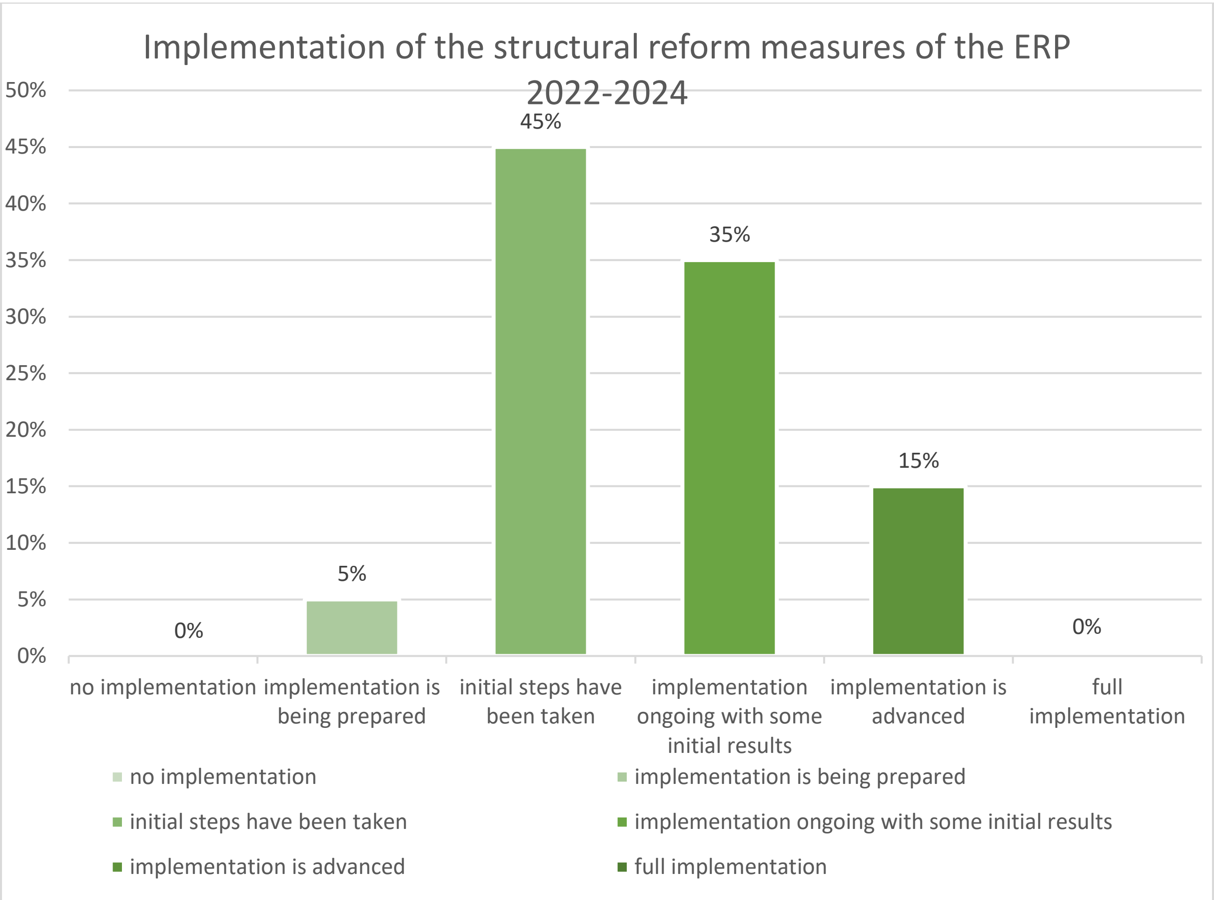
z: Kosovo – Ministry of Health "National Health Accounts 2018" - https://msh.rks-gov.net/wp-content/uploads/2021/07/ENG-NHA-Report-2018-11-July-2021-Final-with-Annex-1.docx

Sources: EUROSTAT and Kosovo Agency of Statistics, unless otherwise indicated.

ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM THE ERP 2022-2024

There was a relatively good progress in the implementation of the measures in 2022, with an average score reported in the ERP of 3.1 out of 5. The reporting on the planned activities provides in general a fair description of the level of implementation.

Implementation is advanced in some measures, such as reform measures 5 (development of policies for EE and RES with a view to the green transition), 6 (energy market reform) and 11 (improving the environment for research, innovation and entrepreneurship). Implementation was low in reform measure 4 (improving of health services) which was removed as a measure in this year's ERP. The variation in levels of implementation across measures is due to some extent to the difference in ambition in the reform measures as well as the specific breakdown into measurable activities.



ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted the Economic Reform Programme for 2023-2025 and submitted it to the Commission on 31 January 2023, within the set deadline. It is in line with the previously approved medium-term fiscal strategy and national development strategy, and the forecasts and amendments made in response to the COVID-19 crisis. No components of the ERP are lacking.

Inter-ministerial coordination

The ERP was centrally coordinated, with the Ministry of Finance, Labour and Transfers as National Coordinator in close cooperation with the Strategic Planning Office in the Prime Minister's Office. They were supported by area coordinators from the line ministries. The inter-ministerial coordination process worked well; however, coordination between the Ministry of Finance, Labour and Transfers, the Strategic Planning Office and the National IPA Coordinator was clearly less strong. IPA activities are only minimally or incorrectly reflected in the structural measures.

Stakeholder consultation

The draft ERP was made available online with 2 weeks for stakeholders to provide their feedback, in line with the rules on minimum criteria for public consultation. In-person consultations were held with representatives from civil society organisations, business organisations, international financial institutions and donors by Commission staff dealing with the ERP. Written comments are annexed to the ERP with an indication of whether they have been accepted or rejected, though they include only comments from one civil society organisation and one private consulting firm.

Macroeconomic framework

The baseline scenario projects a robust acceleration of economic activity with output growth above the historical trend over the forecast timeframe, which is optimistic and requires a careful assessment. External assumptions are based on the projections made in the Commission's autumn forecast and the IMF's October 2022 World Economic Outlook. The ERP assessment of macro projections is based on the ERP annex data, which include some corrections made after the ERP was submitted. The programme provides an alternative 'low growth' scenario. This is useful to illustrate the likely impact of some expected developments and risks on Kosovo's economy, such as underspending of capital investment, lower foreign demand, a slowdown in remittances and higher import prices. The forecasts for the labour market and the financial sector are still lacking.

Fiscal framework

The fiscal projections are based on the adopted 2023 budget. For 2023, the ERP forecasts an increased public revenue-to-GDP ratio, while public expenditure is also set to increase from the 2022 level due to a large surge in capital investment. Some of the 2022-2023 fiscal data are not consistent with the main text. The table of the adopted discretionary measures was provided after the programme was submitted. The ERP provides a useful debt sustainability analysis with three negative shock scenarios.

Structural reforms

The structural reform priorities follow the guidance note and cover the new areas, such as public financial management, the green transition and digital transformation. With some exceptions, the reporting on implementation of the policy guidance is sufficient, but additional explanatory information could have been included in those actions where there is only initial or limited implementation. The reporting on implementation of structural reforms is generally sufficient, though there are some discrepancies between the stated stage of implementation and the description of progress.

The programme meets the limit of a maximum 20 reform measures, although there is an overlap between some measures, which are not coordinated sufficiently. The programme slightly exceeds the page limit. Table 9 is missing. Tables 10a and 10b and Table 11 are only partially correct; especially concerning is the fact that IPA funds are not included in the tables. There are some inconsistencies in the way that the implementation of the reforms is rated.

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