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ECONOMIC REFORM PROGRAMME

OF

KOSOVO*
(2017-2019)

COMMISSION ASSESSMENT

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

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1. EXECUTIVE SUMMARY

Kosovo's* economic growth remained strong in 2016 and will likely continue in the upcoming period. The baseline scenario of the economic reform programme (ERP) is broadly realistic, and forecasts an average GDP growth of 3.9% in 2017-2019, in line with the long-term average. Due to low employment and a narrow production base, stronger private consumption growth is expected to be underpinned by the steady growth of diaspora remittances. The ERP's ambitious forecast of investment growth hinges on the execution of planned increases in budget capital spending, and the finalisation of a deal to construct a major new power plant. The growth contribution of public consumption will remain subdued due to Kosovo's limited fiscal capacity following recent increases in categorical benefits. The main downside risks to the outlook arise from possible political shocks and limited capacities to implement projects at the central and local government level.

The 2017 budget projections, made in cooperation with the International Monetary Fund (IMF), are broadly realistic and in line with the baseline ERP scenario. Revenue is expected to increase strongly in 2017 despite some announced tax exceptions. The envisaged large expansion of expenditure is driven by a substantial increase in capital spending while limits have been introduced on current expenditure increases. The overall deficit is projected to be around 4% of GDP throughout the forecasting period; however the adjusted deficit is expected to stay below the 2% threshold when capital projects financed by international financial institutions (IFIs) and the proceeds of privatisation are deducted, according to the exceptions in the fiscal rule. The fiscal risks identified relate to underperformance of revenue and persistent pressure from large interest groups for increases in entitlements and transfers.

The main challenges facing Kosovo include the following:

- **The mechanisms to monitor budget execution and enforce fiscal rules are weak, and the macro-fiscal framework preparation process is exposed to political influences.** With the addition of a new expenditure rule, setting up proper fiscal monitoring and enforcement mechanisms becomes even more important. Attempts to curb the rise in current expenditure have been limited to introducing ceilings for particular spending items. With limited room for further increases, rising pressures from social groups for new transfers, and the rising maintenance costs of newly built infrastructure, Kosovo needs to contain the rise in current expenditure and preserve the share of capital spending. Furthermore, prudent fiscal policy-making is hindered by the lack of capacities in existing institutions in charge of budget planning, macro-fiscal forecasting and fiscal oversight.
- **Given plans to significantly boost public investment, building up capacity for capital project management, planning and public procurement is becoming increasingly necessary.** The capital investment budget has been consistently under-utilised (on average by 15%) both at central and local government level. Capital spending execution is substantially lower for projects funded by the IFIs showing limited government capacity for managing multiple smaller projects and carrying out more detailed and cumbersome procedures. The expected large IFI supported public investment growth will not materialise unless government capacities are increased.

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- **Kosovo's business environment is seriously hampered by the large informal economy.** Registered businesses continue to experience unfair competition from unregistered ones and problems with accessing finance, thus hampering their ability to grow and innovate. Undeclared turnover and work also have negative effects on public revenue collection and workers' rights. The ERP recognises the informal economy as a problem, but the proposed measures fall short of addressing it in a comprehensive manner.
- **An unreliable energy supply is the main constraint to the development of Kosovo's private sector.** The ERP recognises this and proposes a mix of reforms to overcome it, including new investments in power generation (thermal and renewable sources). This should make it possible to close the most outdated and highly polluting thermal power plant. Combined with much-needed energy efficiency reforms, this would help to address the identified problem. However, energy efficiency measures will have only a limited impact if the private and residential sectors are not covered by the reforms and if energy tariffs are not adjusted to reflect costs.
- **Sluggish job creation is not sufficient for the labour market integration of the increasing working age population, and low skills levels resulting from a weak education system are core constraints to raising prosperity levels of the population.** Continued economic growth in Kosovo has so far not resulted in a substantial increase in employment, as more than half of the working age population is inactive. Women are largely absent from the labour market, and very few young people are in work. Reforms in the education system aimed at improving the quality of teaching and adjusting vocational education and training to labour market needs have started. Labour market institutions, in particular the public employment services, are being built up, but have very limited capacity to provide services and active labour market measures. The social protection system is in an early stage of development with focus on implementing a universal health care system.

The policy guidance jointly adopted at the Economic and Financial Dialogue of 25 May 2016 has been partially implemented. Capacity constraints still hinder macroeconomic forecasting and budget planning, while the process of establishing a fiscal council has not yet moved beyond discussions. Some steps have been taken to contain current spending, and the share of capital spending rose slightly in 2016 with further increases due in 2017. Some initial steps to fight the informal economy have been taken. The Strategy implementation reports for 2015 and 2016 have been finalised after a 2-year gap in reporting. On energy, some positive steps were taken towards the liberalisation of the electricity market, including setting deadlines for the deregulation of prices for commercial consumers. However, no significant energy efficiency measures have been adopted for the private sector. The action plan for tackling youth unemployment has not yet been developed, and the implementation of measures to increase labour market participation of women is delayed. The structural reform measures planned in the 2016 ERP were only partially implemented.

In line with priorities identified by the European Commission in its assessment of last year's ERP, the 2017-2019 ERP reiterates the government's commitment to stable public finances and preserving the share of capital spending. However, recently enacted or announced fiscal policy measures are not always aligned with those goals. The structural obstacles to competitiveness and the reform measures identified in the ERP largely match the analysis of the European Commission. It highlights issues related to access to finance, contract enforcement, informal economy, business regulations, the electricity supply, transport, quality of education and skills gap, low labour market participation and employment. More measures

are envisaged to be taken in areas with particular weaknesses and/or potential, including energy, agriculture, the business environment, foreign trade and education and skills. However, more focus should have been put on social inclusion, reduction of poverty and creating equal opportunities.

2. ECONOMIC OUTLOOK AND RISKS

Economic growth continues to be strong, underpinned by domestic demand, while exports stagnate. Following higher than expected growth in 2015 (4% of GDP), the Kosovo economy continued growing in 2016 at 3.4%, a pace close to its 10-year average of 3.6%. Household consumption remains the largest contributor to GDP growth, driven by strong consumer lending and rising disposable income due to lower energy prices. The strong growth in capital formation was primarily driven by public road investments. Private investments have been held back by a still difficult business climate and by limited, although improving, access to financing for private enterprises. Large infrastructure projects have led to rising imports, especially of heavy machinery and transport equipment. At the same time, exports stagnated as Kosovo's metal exporters struggled to find new export markets and faced low world metal prices. This means that net exports have continued to be a drag on growth.

The continuation of robust GDP growth in 2016 conceals the poor aggregate productivity growth. In 2016 gross value added (GVA) growth was at the lowest level since 2009 (1.6% y-o-y). Productivity stagnation was quite broad-based with only tourism, financial services showing signs of large productivity gains. Productivity in agriculture increased following a large contraction in 2015 but the sector is still underdeveloped due to inadequate investment and ineffective agricultural subsidies. Poorly diversified manufacturing sector recorded declines in productivity due to lower output amid falling demand for metals exports. The difference between the growth of GVA and GDP (1.8 pps) is filled by the net taxes category, reflecting full year effects of VAT and excise increases, and improvements in tax collection.

Table 1:

Macroeconomic developments and forecasts					
	2015	2016	2017	2018	2019
Real GDP (% change)	4.0	3.8	4.5	3.3	3.8
<i>Contributions:</i>					
- Final domestic demand	4.9	7.0	6.9	3.9	4.9
- Change in inventories	0.2	0.0	0.1	0.7	0.1
- External balance of goods and services	-1.1	-3.3	-2.5	-1.3	-1.3
Employment (% change)	-8.2	8.0	4.0	4.0	4.0
Unemployment rate (%) LFS	32.9	:	:	:	:
GDP deflator (% change)	-0.3	0.7	1.7	1.4	1.2
CPI inflation (%)	-0.5	0.0	0.9	0.6	0.7
Current account balance (% of GDP)	-8.9	-	-	-	-
		11.0	11.6	11.4	11.4

Sources: Economic Reform Programme (ERP) 2017

The ERP 2017-2019 projects some moderation of growth compared to the previous years' programme. Following the continued growth in 2016, GDP growth is expected to strengthen again in 2017 to 4.5%, before easing off to around 3.6% in 2018/2019. Private consumption growth is projected to continue, providing the biggest contribution to GDP. It is expected to grow by 3.8% on average over 2017-2019, underpinned by stronger consumer

lending and expected improvements in the labour market. Public consumption is set to remain subdued as a result of rules regulating increases in public current expenditure. Investment growth is projected to further accelerate in 2017 (14.9% y-o-y), supported by several new public investment projects financed by the IFIs. Investment growth is expected to taper off later in the forecasting period as fiscal space for new investments is depleted and private investments struggle to gain pace. Owing to Kosovo's narrow export base, the recovery of export growth, which is expected to average 3.5% in 2017-2019, will primarily depend on external demand for metals, despite signs of stronger service exports. Import growth is set to average at 4.7% during this period, reflecting strong investments trend with a substantial import component. On the production side the services sector is projected to grow by 4.3% over 2017-2019, driven by trade, transport and IT. The industry sector is expected to recover (5.6% average growth in 2017-2019) following a contraction in 2016. However, it remains reliant on low-value-added production of metals and constrained by the shortage of high-skilled labour force. The construction sector is largely dependent on large public investment projects and is expected to grow by 4.7% throughout 2017-2019. Expected growth in agriculture (2.6% on average) is not seen as particularly significant, especially following continuation of agricultural subsidies and several announced initiatives for improving the sector's competitiveness.

The ERP's broadly plausible growth scenario is in line with Kosovo's long-term averages, but faces a number of downside risks related to lower investment, energy security, fiscal stability, and political instability. The main downside risk to growth will come from lower than planned execution of capital spending financed under the two exceptions under the fiscal rule. Kosovo's administration has so far struggled to absorb funds from IFIs due to low administrative capacity. The planned amount of new IFI-supported capital spending is several times larger than the overall disbursement by IFIs in 2016 (EUR 10 million). Furthermore the government has often overestimated the funds expected from privatisation and liquidations (EUR 277 million expected in 2017-2019). Lower investment expectations, especially in 2017, are reflected in somewhat less optimistic growth forecasts from the IMF and the World Bank (3.5% and 3.9% respectively). As Kosovo's electricity production capacities are prone to malfunctions, a large production disturbance would raise energy import needs, harming the financial performance of electricity production and distribution companies and would requiring a substantial increase in state energy subsidies (0.7% of GDP increase). Risks of delays and backtracking of reforms and ad hoc increases in current spending also remain significant, especially following the expected end of the IMF Stand-By Arrangement (SBA) in August 2017. Furthermore, political instability could further undermine a business environment already struggling with an inefficient judiciary, weak contract enforcement, a widespread informal economy, and an inefficient and unaccountable public administration. This makes it harder for private sector to become more dynamic and resilient private sector development. The ERP contains a full account of downside risks, but the quantification of their impact on growth and public finances seems overly optimistic, lowering average growth by 1.1 pps with only limited fiscal impact.

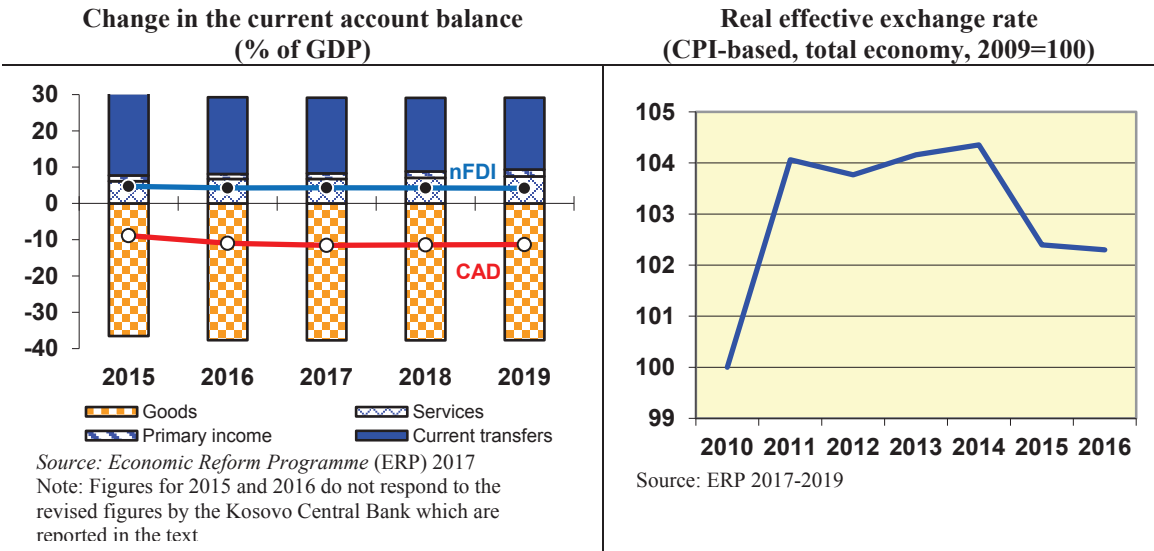
The construction of new electricity production capacities and higher private investment growth are upside risks, although these are less likely to materialise. The new power plant investment project, worth EUR 1 billion (15.6% of GDP) spread over 5 years seems to be in the final stages of preparation and is expected to start in 2018. However, the project was already delayed several times due to disagreements between the government, IFIs and the investor, in particular over the price of electricity and the return on the investment. Another upside risk comes from stronger private investments following the adoption of the second

fiscal reform package. However, its impact will likely be marginal given the narrow scope of the measures planned.

Kosovo remains heavily dependent on price developments in its main trading partners, namely the EU. The trend of decreasing price level that started at the end of 2014, seems to be bottoming out as the CPI price level increased slightly in 2016 (0.3% y-o-y). However, food and energy prices were slowly recovering towards the end of the year. Inflation in Kosovo is expected to remain around 1% throughout 2017-2019. This appears slightly underestimated given improving inflation prospects in the main trading partners, the EU and Central European Free Trade Agreement (CEFTA) countries, consumer price inflation (CPI).

Kosovo's weak and unproductive economic base translates into strong import dependence and a significant current account deficit. Kosovo's exports are mostly metals, minerals and low-value added products, heavily dependent on world commodity prices. In 2016 the current account deficit widened to around 9.4% of GDP, mainly as a result of lower income balance and government transfers. Current account balance is expected to deteriorate further throughout the forecasting period to around 11% of GDP due to deterioration of the trade balance. The import component of stronger domestic demand will remain substantial, as development of domestic production capacities is progressing slowly.

Graph 1: External competitiveness and the current account



The financing of the current account remains heavily dependent on unrecorded flows and volatile inflows of net foreign direct investment (FDI). In 2016 net FDI inflow decreased to 3.3% of GDP. However, the structure of FDI inflows remained largely the same, with real estate and construction taking up almost 90% of total FDI inflows. Changing this pattern towards greenfield investments in tradable production sectors will require broad-based reforms to strengthen protection of property rights, improve human capital and establish a stable electricity supply. The Stabilisation and Association Agreement (SAA) with the EU, in force since April 2016, should also raise Kosovo's profile among investors.

Despite continued growth, Kosovo's labour market conditions remain a serious concern. In 2015 the sharp drop in employment, despite stronger growth, coincided with a large wave of emigration, but employment likely rebounded in 2016. The ERP optimistically expects employment to continue increasing on average by 4% over the forecasting period. This will not be enough to absorb the large inflow to the labour force (2% annually) and substantially reduce already high unemployment (27.5% in the third quarter of 2016) or increase the abysmally low participation rate (40.2% in the third quarter of 2016). The ERP again does not

provide forecasts for unemployment or activity rates; however drastic changes can hardly be expected. The proportion of long-term and unemployed young people is likely to remain high. Due to the poor quality of education and low overall skills level in the labour force, a substantial skills premium for skilled workers is observed across all sectors and professions. Furthermore, the ‘Dutch disease’ effect of the large inflow of remittances increases the wage reservation level and discourages labour force participation. Labour productivity is projected to remain flat (-0.1% growth on average) despite expected low growth of wages.

Table 2:

Financial sector indicators

	2012	2013	2014	2015	2016
Total assets of the banking system, mEUR	2,830	3,059	3,187	3,387	3,637
Credit growth	3.8	2.4	4.2	7.3	10.4
Bank loans to the private sector %	52.6	50.5	44.9	41.5	40.0
Deposit growth	8.3	7.5	3.6	6.5	7.2
Loan to deposit ratio	80.7	78.0	74.9	75.3	78.4
Financial soundness indicators					
- non-performing loans	7.5	8.7	8.3	6.2	4.9
- net capital to risk weighted assets	14.2	16.8	17.8	19.0	17.9
- liquid assets to short-term liabilities	39.1	48	43.6	44.9	41.5
- return on equity	7.1	9.4	20.2	26.4	18.5
- forex loans to total loans	0.0	0.0	0.0	0.0	0.0

Sources: National Central Bank, DataInsight

The banking sector remains stable, liquid and profitable, but also heavily under-utilised. Credit growth in 2016 (10.4%) was driven by stronger demand, especially by households. Lower lending standards and decreased interest rates helped increase overall demand for loans. Despite falling revenue (-3%), the banking sector remained profitable (18.5% return on equity) and strengthened its portfolio quality (4.9% non-performing loans). The loans-to-deposit ratio and the bank-loan-to-GDP ratio stood at 76.9% and 37.1%, respectively, indicating ample potential space for further financial intermediation. Unfortunately the ERP scenario does not provide specific numbers on developments in the financial sector in the forecasting period. It can be assumed that stronger credit growth would resume as private consumption and investment are expected to be the main drivers of growth.

3. PUBLIC FINANCE

In 2016, public finances benefited from strong revenue performance, while spending composition slightly improved despite hasty introduction of new categorical benefits. The initial 2016 budget was prepared under the IMF stand-by arrangement and thus provided realistic estimates of both revenue and expenditure. It was revised in July 2016 due to the introduction of new spending categories, although with little change to headline figures. Compared to 2015, budget revenue grew by 8.6% in 2016, driven by strong growth in tax revenues, due to the full year effect of the 2015 policy changes to VAT and border excise. Increased economic activity, higher company profits and rising employment also strengthened collection of corporate and personal income taxes while debtors took advantage of incentives derived from the law on debt forgiveness to increase collection of more recent property tax

arrears. As expected, customs revenue decreased slightly due to application of the SAA with the EU since April 2016. Overall budget expenditure was 6% higher than in 2015. After 2 years of growth, current expenditure as a share of total spending fell in 2016 to 73.2%, from 74.2% in 2015. The reduction current spending's share came despite the introduction of pensions for war veterans and initial ballooning of the programme's costs. Despite overall reasonable execution of capital spending (88.7%), lower than planned collection of municipal own-source revenues depressed capital spending at local level. The overall deficit stood at only 1.3% of GDP or 0.9% of GDP when calculated according to the fiscal rule, well below the 2% threshold.

Ensuring medium-term sustainability of public finance and strengthening growth friendly capital spending are Kosovo's main public finance objectives in 2017-2019.

Kosovo's budget has always been characterised by the large share of capital spending, reflecting its large investment needs. Nevertheless, current expenditure has recently been growing in share, as Kosovo built its institutions and introduced new, not always targeted, social policies. Short sided, ad-hoc rises in public wages, pensions and other transfers to specific interest groups, further squeezed the share of capital spending. To strengthen fiscal stability and preserve capital spending Kosovo has introduced several rules-based mechanisms. The fiscal rule implemented since 2014 limits the deficit to 2% of GDP and the law on public debt sets the long-term public debt level ceiling at 40% of GDP. The amendment to the fiscal rule, known as the "investment clause", was adopted by Assembly to expand fiscal space in the short term. This makes it possible to exclude new donor-financed capital projects from the headline deficit, as long as debt level is below 30% of GDP. Furthermore, capital investment financed by privatisation proceeds was already exempt from the headline deficit provided that the government deposits amount to at least 4.5% of GDP. To limit the rise of current expenditure and align unit labour costs to productivity growth, starting in 2018, a rule governing rises in the budget wage bill will be implemented, limiting its annual growth to that of nominal GDP.

Table 3:

Composition of the budgetary adjustment (% of GDP)

	2015	2016	2017	2018	2019	Change: 2016-19
Revenues	25.5	26.6	26.9	26.7	26.8	0.2
- Taxes and social security contributions	22.6	24.3	24.1	24.2	24.4	0.1
- Other (residual)	2.9	2.4	2.8	2.5	2.4	0.0
Expenditure	27.1	27.7	31.2	30.7	30.6	2.9
- Primary expenditure	26.8	27.4	30.9	30.3	30.2	2.8
<i>of which:</i>						
Gross fixed capital formation	7.0	7.4	11.3	11.2	11.5	4.1
Consumption	12.7	12.4	12.4	12.3	12.1	-0.3
Transfers & subsidies	7.2	7.9	7.4	7.1	7.0	-0.9
Other (residual)	-0.1	-0.2	-0.2	-0.4	-0.4	-0.2
- Interest payments	0.3	0.3	0.4	0.5	0.4	0.1
Budget balance	-1.6	-1.1	-4.3	-4.0	-3.8	-2.7
Budget balance as per fiscal rule	-1.4	0.9	-1.5	-1.4	-1.2	-2.1
Primary balance	-1.3	-0.7	-4.0	-3.6	-3.4	-2.6
Gross debt level	13.0	14.2	17.9	20.4	22.0	7.8

Sources: Economic Reform Programme (ERP) 2017, ECFIN calculations

The revenue projections for 2017 are ambitious but become more realistic in 2018-2019.

The 2017 budget, adopted by the assembly in December 2016, aims at a fiscal deficit of EUR 97 million or 1.5% of GDP¹, in line with the fiscal rule. The budget is based on nominal GDP growth of 6.3% in 2017 and CPI inflation of 0.9%. Total revenue is expected to be EUR 1.73 billion, 7.5% higher than in 2016. The increase should result mainly from stronger economic growth, planned changes to tobacco excises and improvements in revenue collection. Although taxes collected at the border currently account for most of the budget revenue, the further implementation of the SAA with the EU will gradually lead to a shift towards domestically collected taxes. The largest contribution to growth of revenue is expected to come from VAT (7.8 growth y-o-y). This is due to rising domestic demand as well as collection of delayed VAT payments for imported lines of production introduced in September 2015. Somewhat puzzling is the expected high contribution from the growth of non-tax revenue. The collection of these revenues at both central and local level was poor in 2016 (80.9%), but the 2017 budget still expects an increase in collection of 0.5% of GDP. Revenue forecasts for 2018 and 2019 are set to closely follow nominal GDP growth.

The 2017 budget makes provision for strong fiscal expansion through new capital investment spending. However, full execution of the planned investment spending remains unlikely. Expenditure is forecast at EUR 2 billion in 2016, 20.8% higher than in 2016. Current expenditure is expected to increase by 5.1%, assuming the amount available for war veteran's pensions is limited to 0.7% of GDP and the government keeps to its commitment to limit overall spending on war veterans' benefits to 1.25% of GDP. A substantial increase in goods and services spending (11.5% y/y) is not explained in detail. Kosovo should however, improve its maintenance of existing infrastructure to avoid higher costs in the future. Budget capital spending is ambitiously planned to increase by 62.8% in 2017. The increase is largely due to projects financed by IFIs (1.7% of GDP) and privatisation proceeds (1.4% of GDP). Kosovo has so far constantly underspent its investment budget due to limited administrative capacity, especially when more stringent procurement and multi-year planning procedures are required as in projects financed by IFIs. Moreover, the projects identified for funding under these schemes are in different stages of preparation. Therefore the proposed investment spending plan will likely be spread across a longer period resulting in lower overall growth of expenditure. In 2018 and 2019 overall expenditure growth is expected to remain subdued, growing 3.9% on average.

The risks to the ERP fiscal policy scenario are present in 2017. The IMF programme was delayed in 2016 due to the higher than expected costs of the war veteran pension scheme. The second and third reviews of the programme were merged, delaying disbursement of the associated tranches of the loan. The total amount available for war veterans' benefits was limited to 1.25% in the 2017 budget. Additionally the annual cost of war veteran's pension scheme was limited to 0.7% of GDP, and an independent commission to reviewing the lists of eligible war veterans was set up. Following the fulfilment of the prior actions the IMF board finally approved the second and third review of the SBA in March 2017. To complete the fourth review of the programme the government will need to reform the war disability pension scheme to help limit the overall war veteran related spending to 1.25% of GDP. To help limit overall expenditure on war veteran pensions the government has committed to quickly complete the war veteran reclassification process. If revenue growth is lower than expected, the capital budget will likely be used as a buffer as potential savings on the current expenditure side are limited and substantial cost-cutting reforms are unlikely given the possible early elections. Political risk remains pronounced, especially if there are early

¹ This figure refers to the deficit calculated according to the fiscal rule

elections, during which fiscal stability could be endangered by the propensity of political elites to ingratiate themselves with large interest groups such as public-sector employees, pensioners and war veterans through ad hoc increases of benefits. The absence of a policy anchor after the completion of the IMF programme in August 2017 could result in a period of uncertainty in the second half of 2017 when the 2017 budget revision could come under pressure from groups with a vested interest in increasing wages, before the ‘wage rule’ comes into force in 2018. The preparation of the new law on salaries paid from the budget will need to be monitored closely. The law should be part of a broad reform package prepared, inter alia, to remodel wage policy in Kosovo's public sector using more equitable and efficient principles, but could provide the basis for another major increase in public-sector wages. This would not only undermine the whole reform but also substantially deteriorate public finance stability.

Table 4:

Composition of changes in the debt ratio (% of GDP)					
	2015	2016	2017	2018	2019
Gross debt ratio [1]	13.0	14.2	17.9	20.4	22.0
Change in the ratio	2.5	1.5	3.6	2.5	1.6
<i>Contributions [2]:</i>					
1. Primary balance	1.8	1.7	1.5	1.6	1.6
2. “Snow-ball” effect	-0.1	-0.2	-0.5	-0.4	-0.5
<i>Of which:</i>					
Interest expenditure	0.3	0.3	0.4	0.5	0.4
Growth effect	-0.4	-0.5	-0.6	-0.6	-0.7
Inflation effect	0.0	-0.1	-0.2	-0.2	-0.2
3. Stock-flow adjustment	0.8	-0.1	2.6	1.3	0.5

Notes:

[1] End of period.

[2] The snow-ball 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

Source: Economic Reform Programme (ERP) 2017; ECFIN calculations

Announced policy changes are few and vaguely presented. As a potential policy change on the revenue side the ERP mentions the adoption of the *second fiscal reform package*. Among other things, the package tries to address the cash flow problems companies' face when importing production inputs or investment goods due to the nature of Kosovo's customs system. The package (i) makes provision for amendments to the list of products subject to a 0% or reduced 8% VAT rate; (ii) expands the list of products exempted from customs duties and excise; (iii) introduces tax holidays for new businesses. While the first fiscal reform package adopted in 2015 was justified as a part of the IMF-supported fiscal consolidation efforts, this package constitutes a clear fiscal easing. Furthermore, proposed measures do not solve the cause of the cash flow problem for companies and would create unequal treatment of businesses in different sectors. The package was not agreed with the IMF and was not incorporated in the 2017 budget revenue projections. The announced merger of the tax administration and customs authorities will not likely happen in 2017. The expected high savings and increases in productivity due to the merger seem unsubstantiated. Nevertheless the merger should be carried out in a transparent way with a clear action plan. The risk of political interference is likely to be significant. A mandatory health insurance system is expected to be introduced in Kosovo in July 2017. Some EUR 17 million was budgeted for 2017. However the full year cost will likely be higher as the budget cost of covering vulnerable categories is not yet known.

The institutional public finance framework is not complete. Kosovo's fiscal policy is characterised by repeated ad hoc decision-making with significant budget impact, such as commitments to large infrastructure projects and across-the-board increases in wages, pensions and other entitlements, especially in pre-election periods. The main purpose of the fiscal framework should be to limit and discourage such practices. Kosovo's fiscal framework consists of a combination of expenditure, deficit and debt rules. The credibility of the framework is questionable as the rules are often amended with new exceptions or supplemented with limits on specific spending categories. Furthermore the framework lacks strong enforcement and monitoring mechanisms. Institutions with some oversight duties over budget preparation and execution lack capacities and resources.

Public debt is low but remains sensitive to refinancing and fiscal shocks. At the end of 2016 public debt and issued guarantees stood at 14.5 % of GDP. This was 1.5 pps higher than in 2015. Around 56% of the debt is domestically issued, in the form of short-maturity treasury bills and bonds, while the rest is mainly held by the IFIs. Due to a large increase in investment spending, which is not counted in the official deficit numbers, the budget's net financing needs will be on average 4.5% over the forecasting period. The debt level is expected to reach 22% of GDP by 2019. The average weighted interest rate (2.6% in 2016) is projected to slightly increase in 2017 to 2.7%, before easing in 2019 to 2.2%. Total financing needs are highest in 2017 (10.8% of GDP) and fall gradually to 7.7% of GDP in 2019. Higher external borrowing in 2017 is due to the disbursement of the final tranches of the IMF programme and the onset of the borrowing from the IFIs on the basis of the 'investment clause'. However low administrative capacity for project preparation and management, and a requirement for the approval of a two thirds majority in the Kosovo Assembly of any external borrowing may delay disbursement from the IFIs planned for 2017. Domestic debt is still dominated by shorter maturity bonds and treasury bills, although the average maturity has been increasing gradually (15 months at end 2016). Kosovo still does not have access to international debt markets due to the lack of internationally credit rating and relatively large fixed costs of issuing debt internationally. To provide an additional financing buffer in case of emergency, the government deposits were replenished towards the level implied by the fiscal rule (4.5% of GDP) following the disbursement of the second and third tranche of the IMF loan. The long-term public debt sustainability analysis presented in the ERP highlights Kosovo's limited room for deviations from the fiscal rule.

4. STRUCTURAL REFORMS

There has been a significant improvement in the structural reforms part of the ERP. The ERP properly identifies key obstacles to improving competitiveness, employment and social development and the measures proposed respond to the challenges identified to a large extent. The ERP's analysis is consistent with the Commission's assessment of key competitiveness obstacles, and the findings of the Commission's assessment of the 2016 ERP have been used to draft the measures included in this year's programme.

The 20 reform measures included are spread across the nine different areas reflecting well the overall weak competitiveness of Kosovo's economy. Some areas are given more focus by including more than one measure, including the energy market, agricultural sector, business environment and informal economy (five measures), external trade, and education and skills. This is broadly justified by the severity of problems and/or the sector's potential. There is a good mix of legislative, administrative, grant-based and infrastructure reforms without overemphasising infrastructure but rather looking at genuine structural reforms. Budget contributions are planned for all but one measure, showing strong government

commitment to the content of the reforms. Most, but not all, measures are co-financed by IFIs or donors.

Among the main obstacles to competitiveness and growth are an unreliable, and health hazardous energy supply, a very large informal economy (estimated at 39% of GDP) and the low work intensity of the economy due to the lack of jobs and low skills level.

The energy sector suffers from outdated production capacity, low energy efficiency, a non-liberalised energy market and a tariff system that does not reflect real costs. The informal economy distorts competition, and reduces public revenue collection and workers' rights. Moreover, unregistered small and medium-sized enterprises (SMEs) do not have the same access to financing as registered ones. The inadequate pace of job creation has led to very high unemployment and an inactive young population. Last year's policy guidance covered these areas specifically, but they have been only partially addressed.

Public finance management (PFM)

Kosovo's public procurement is characterised by low transparency, giving rise to corruption and inhibiting competition. The ERP identifies that the lack of transparency in public procurement excludes SMEs from competition for public contracts and reduces confidence in state institutions. The ERP highlights weak capacity of public procurement bodies, insufficient monitoring and enforcement, and not fully functional remedy system as remaining challenges in this area. The analysis lacks, however, a wider overview of PFM.

The measure aimed to establish an electronic public procurement will help reduce costs and increase transparency. Some advances were made in the legal framework with the adoption of the new public procurement law in 2016. However the weaknesses in the Central Procurement Agency were preventing the swift application of the electronic procurement. Continuing the further development of the electronic procurement, as proposed in the ERP, is consistent with the area diagnostic and Kosovo's PFM reform programme. It links with the goal of improving the capacity of the central procurement agency and public review body (PRB), monitoring the contract and market prices, and publishing all PRB decisions identified in the National Strategy and Action Plan on Public Procurement. It is not clear if all the proposed actions (i.e. IT systems and awareness-raising) will have the necessary budget allocation. Moreover, to have the expected impact, the measure would require awareness-raising, and digital skills capacity building activities for SMEs in Kosovo to fully access and use e-procurement.

Transport, energy and telecommunications markets

Kosovo's competitiveness is severely hampered by the unreliable energy supply and dysfunctional energy market, and the existing transport infrastructure is poorly maintained. Available energy production capacities are highly polluting and prone to malfunctions, while distribution is characterised by large losses due to poor infrastructure. Lack of investments in energy efficiency further increases the cost of energy. The energy market is not functioning on free market principles and existing tariff subsidies cause a fiscal risk. The ERP highlights the inadequacy of roads and railway networks as main weaknesses in the transport sector but does not cover more structural challenges related to the regulation of the network markets. The refocus of this year's ERP away from transport infrastructure measures (which are supported in the context of the EU-led Connectivity agenda), towards more structural obstacles to competitiveness related to the business environment and skills is thus welcome. The ERP points to the unbalanced distribution of information and communications technology (ICT) infrastructure as the main obstacle to the development of the telecommunication market. This is, however, also very much compounded by a lack of ICT skills, and insufficient competition in this area.

The measures on energy are clearly relevant although it is not clear if they are aligned with the reforms included in the Energy Strategy. Progress in 2016 was mainly limited to legislative measures and the introduction of some energy efficiency measures. Foreseen energy efficiency investments still focus exclusively on public buildings, ignoring the residential sector, the largest consumer of energy in Kosovo; this shortcoming of the ERP was highlighted in the 2016 policy guidance. The measure is unlikely to have the expected impact unless the reform also tackles regulatory barriers, municipalities' limited access to credit to adopt energy efficiency measures and the absence of a sustainable energy efficiency financing mechanism in Kosovo.

The measure to further develop energy generation capacity is rolled over from the 2016-2018 ERP and responds to a clear need. However, most of the work planned for 2016 was not done (only the feasibility study for the rehabilitation of Kosovo B thermal power plant has started). The cost estimates of the new planned actions (1 new coal powered thermal power plant, 3 solar, 20 hydropower and 2 wind power plants) are very rough, and without a clear regulatory framework. Moreover, serious risks relating to the process of construction of the different generation plants, and the risks of importing electricity, are underestimated or not mentioned at all.

The measure to extend the ICT network infrastructure is rolled over from the 2016-2018 ERP and is still relevant. Very limited progress was made in the implementation of this reform in 2016 (the timeline was not clear in the previous ERP). The first component of the programme for Kosovo's Digital Economy (KODE) was put on the priority investments list, for which there is a derogation from the fiscal rule. Last year's ERP assessment highlighted the need to complement infrastructure investments with an adequate supply of educated computer engineers, increased competition between operators and independence of the regulator. However, none of these issues have been considered in this year's ERP. Moreover, Kosovo should review the definition of broadband in the KODE (from 512 kbps to e.g. 10-30 Mbps or higher) and specify the targeted penetration rate. To have the intended impact in terms of improvement of access to international markets, development of new business models and increased GDP growth, the measure should target not only ICT businesses but also traditional industries to help them with innovation and competitiveness. This should encompass support for the development of e-skills at different levels, from primary schools to vocational training.

Sector development

Agricultural sector development

Kosovo's agriculture sector suffers from low productivity which contributes to the widespread poverty in rural areas. The ERP's diagnostic highlights the fragmentation of agricultural land, the small size of farms and outdated farm technologies, the absence of modern agricultural skills, the lack of investment in irrigation and the lack of diversification of agricultural products as main obstacles to the sector's competitiveness.

In this context, the measures on investments in agricultural infrastructure and agro-processing and efforts to consolidate land parcels should contribute to increasing productivity in the sector. The infrastructure and agro-processing investment measure is rolled over from the 2016-2018 ERP and some activities seem to have been carried out in 2016 through calls for applications. However, there are no figures for the increase in irrigation coverage, the wholesale agriculture market infrastructure or the number of testing units in laboratories. Some of the targets set for the coming three years are rather ambitious (an annual increase of 13.5% of the area under irrigation; a 20% increase of exports and a 10% fall in import substitution in the products supported; and 15% net added gross value in supported

enterprises), but the activities presented to achieve these targets are rather general. It is therefore not clear how realistic they are. Moreover, there are no baseline figures provided to be able to monitor/evaluate them.

The measure to regulate and consolidate agricultural land is also rolled over from last year's ERP and it continues to be fully pertinent. However, the measure basically relies on voluntary consolidation and does not provide any indication of the target to be achieved at the end of the process.

Industry sector development

Kosovo's industry is characterised by low-value-added and undifferentiated production. The sector is dominated by SMEs with a low level of FDI. The ERP assessment mainly focuses its diagnostic on the weak cooperation between companies and the lack of coordination through industry associations. It leaves out the lack of support services to industries, and other structural problems in the main industries (such as mining or textiles) preventing the development of higher value-added product chains.

The measure to support the development of industrial clusters could help companies to create synergies, learn from each other. It is rolled over from the 2016-2018 ERP; however, it still fails to explain why this is considered the most relevant action in this sector compared to other actions envisaged in Kosovo's industrial policy and the private sector development strategy. Only limited progress has been made in relation to the activities planned for 2016. The activities planned for 2017-2019 are not ambitious enough to have a real impact on the competitiveness of the Kosovo economy.

Services sector development

The service sector contributes 58,2% of the gross value added and it is the fastest growing export sector. The ERP does not contain a proper analysis of the services sector as a whole and only identifies obstacles in the tourism sector. Other services such as ICT, retail and wholesale, professional services etc. are not mentioned. Moreover, major obstacles to the development of the services sector such as a lack of skills, an incomplete legal framework and an inadequate system of mutual recognition of professional qualifications are also not analysed.

The measure to develop tourism products in Kosovo's tourist regions and increase the economic value of tourism is new and it could have a major impact on the economy. However, the planned actions could be better sequenced: they should start with drafting a sector-wide Action Plan for tourism in Kosovo, involving all relevant stakeholders (notably municipalities and the private sector). This plan could include some of the actions proposed for 2018 and 2019 (e.g. data collection, analysis of potential and evaluation of needs for the different categories of tourism and regions). Specific actions could then be developed in certain regions, as already proposed for 2017.

Business environment and reduction of the informal economy

Informality, poor access to finance, weak rule of law, and low administrative capacities are among the main challenges to private sector development and to competitiveness. The diagnostic recognises these challenges, but leaves out some other pertinent negative characteristics of Kosovo's investment climate, such as the complex and changing regulatory framework, insufficient consumer protection, a complex market surveillance system, and poor accounting, auditing and financial reporting standards.

The five measures proposed are rolled over from the 2016-2018 ERP. However, in last year's ERP most of them lacked detailed information as to the activities planned in each year, which makes an assessment of implementation in 2016 very difficult.

The measure to strengthen evidence-based policy-making and reduce the administrative burden is relevant. However, the link between the measure proposed and the improvement of the business environment should be made clearer. It is loosely linked to the Regulatory Impact Assessment (RIA) measure of the 2016-2018 ERP, even though the activities planned are different. Last year's measure was partially implemented through the certification of RIA trainers.

The measure to facilitate property rights recognition and their registration in the cadastre will enable the use of previously inactive assets as lending collateral and thus facilitate the access to finance. The measure was rolled over from the 2016-2018 ERP and was partially implemented in 2016 through the adoption of the National Strategy for Property Rights and the concept paper on public property. The activities envisaged for the next three years, however, are quite ambitious and possibly underestimate the risks associated with the achievement of a unified cadastre and the settlement of disputes.

The measure on reducing the court case backlog should help to improve the judiciary efficiency but will require broad support from all relevant stakeholders, which was not the case so far. It is rolled over from the 2016-2018 ERP and activities planned in 2016 were partially implemented: the legal framework was amended so that the judicial system only handles minor cases if they are contested by the parties. It is worrying that the special team to reduce the backlog of cases was not established due to budgetary constraints and that the project implementation of the Case Management Information System has been delayed. The activities planned in 2017-2019 are important and relevant with a significant potential impact on the business environment.

The measure aimed at the full operationalisation of the Kosovo Credit Guarantee Fund could improve access to finance for businesses. However the projected increase in credit and jobs appears quite unrealistic. The measure was rolled over from the 2016-2018 ERP. In 2016 the regulation on organisational structures was adopted and the Board of Directors was put in place. Agreements were signed with five commercial banks, but the government committed only EUR 2 million to the fund, as opposed to the EUR 3 million initially planned, with the last million planned to be transferred in 2017. If duly implemented, the measure has the potential to bring economic benefits, notably if done in conjunction with other reform measures included in the ERP which also affect access to finance (combating the informal economy, strengthening the property rights system and increasing judicial efficiency).

The measure aimed at merging the Kosovo customs and tax administrations and establishing a single Revenue Collection Agency should be done without any politicisation to achieve the foreseen efficiency gains. It is also rolled over from the 2016-2018 ERP and the activities planned in 2016 were partially implemented through finalising the action plan for the merger. However, the legal base has not been established yet. To have the expected impact in terms of expanding the tax base, efficiency gains in the revenue collection and reducing informalities and the coordination between the main decision making actors must be improved.

Research and innovation

Kosovo's capacity for research, development and innovation (RDI) is very low, which limits the creation of new jobs. The ERP recognises that and points out the lack of a legal and policy framework as well as the low level of political commitment to RDI, which is

reflected in the very low public expenditure (0.1 % of GDP). The analysis also adequately signals the lack of incentives for the private sector and academia, although there is no reference to the companies' low absorption capacity and universities' limited capacity for specialised research and lack of results in commercialisation.

The measure to improve the policy and strategic framework is new but the expected impact may not be achieved if the measure is not complemented by more ambitious actions to assist and boost applied research activities in Higher Education, and to substantially improve cooperation between research institutes and businesses.

External trade and investment facilitation

Kosovo is not yet fully integrated in the global economy. Obstacles to increasing trade openness include the high cost of cross-border trading which is linked to procedural, quality, logistical and border obstacles to exports, as well as the certification of Kosovo products and a lack of experience in marketing and sales, which makes it difficult for Kosovo's companies to win contracts in European markets. The ERP recognises these challenges but the critical importance of engaging with the private sector is not sufficiently considered.

The measure to increase the cost efficiency of international transactions (through simplification and standardisation of customs formalities and procedures) is clearly linked to the diagnostic and to the need to eliminate non-tariff barriers to trade. It should thus help to reduce the costlier and more cumbersome procedures that Kosovo suffers to export compared to its regional peers. However, its design would benefit from setting priorities as it includes too many activities. The allocation from Kosovo's budget seems very limited (EUR 10,000) and the activities are expected to be supported by donors (although the level of support and overall cost of the measure is not clear).

The measure on quality infrastructure has become even more relevant in view of the obligations taken on by Kosovo following the signing of the SAA with the EU. It is rolled over from the 2016-2018 ERP, and the activities planned in 2016 were partially implemented. Almost 1400 European and international standards were adopted and awareness raising activities were implemented as planned. However, there was no progress on the completion and establishment of new laboratories, or on increasing the number of conformity assessment programmes. No progress was made in further completing the legislative framework. To have the expected impact, a more holistic approach is needed to the challenges in the three pillars of quality infrastructure (standardisation, metrology and conformity assessment, including certification and accreditation).

Moreover, some challenges to the implementation of this measure, like the weak inter-institutional coordination between relevant ministries and quality infrastructure institutions and the lack of qualified staff, are not identified. The measure also mainly focuses on regulatory work and adoption of legislation while it should also aim at enhancing the support for companies to comply with EU standards (access to expertise/financing) and address the constraints that SMEs face in adapting their production methods and facilities.

Education and skills

The results of the first PISA survey have revealed a considerable gap in education outcomes, placing Kosovo considerably below the Western Balkans region and EU averages. The country's young population can only become a real asset for economic development if rapid progress is made in stepping up the quality of education at all levels. Education is a strong priority in Kosovo's National Development Strategy, which is reflected to some extent in the ERP. The ERP identifies primarily the low participation in pre-school

education as one important factor impeding skills development from early years on; however, it does not present measures for increasing participation.

First steps have been taken for implementing the reform of the teachers' career system. The measure is rolled over from the previous ERP. This reform should be pursued without further delay, its initial timeframe 2016-2018 already extended to 2019, and concentrate on the delivery of pre- and in-service teacher training.

A new priority measure foresees adjusting skills supply and demand by developing new occupational standards and reviewing the curricula in vocational education and training accordingly. The lack of skills in demand, such as IT skills, is a key factor hampering business expansion and job creation. The measure is a step in the right direction, provided that it is based on the identification of labour market needs and embedded in a more general review of the current VET provision.

Employment and labour markets

Kosovo is facing a huge challenge stemming from jobless growth and a steady increase in the working age population. The ERP diagnostic based on the official labour market statistics of Kosovo indicates that Kosovo continues to have by far the lowest activity and employment and the highest unemployment rates in the Western Balkans region. Of particular concern is the very low employment rate below 30%, while 40% of male and 80% of female working age population declare to be inactive. Only two cohorts stand out with higher activity rates, men aged 30-50 (80-83%) and women aged 25-35 (28-29%).

Despite positive growth rates over the past years, the private sector economy is still too small to generate larger numbers of new jobs. Although data for the first three quarters of 2016 indicate a net increase in employment, this is only catching up from previous decreases in 2014 and 2015, while the labour force has grown over the same period. Substantial job creation will to a large extent depend on making progress in moving from consumption-led growth relying on remittances to growth through productivity increases and export-oriented goods and services.

The estimated labour force increase of 30.000-45.000 persons per year steadily aggravates in particular the position of young people lacking employment prospects. Out of the 330.000 youth (15-24), 30% are not in employment, education or training. Only 23.3% are active on the labour market, and a mere 10.5% are employed. It is of utmost urgency to start creating opportunities for young people, so that their talents can contribute to developing the country's private sector, in particular in those sectors identified as having a growth potential. Kosovo should without further delay respond to the 2016 policy guidance on developing an action plan for tackling youth unemployment, in cooperation with all relevant domestic and international actors.

Labour market institutions supporting both jobseekers and employers are still in an early stage of development. The reform measure for establishing the Employment Agency into a self-standing institution that could provide client-oriented counselling and mediation services and implement active labour market programmes is rolled over from the previous ERP. First steps have been completed in 2016, mainly focussed on internal administrative issues of the Agency. Active labour market measures are being programmed and implemented, however, with a far too modest scope.

Social inclusion, poverty reduction and equal opportunities

Kosovo is facing multiple social challenges stemming from low employment, while the social protection system is in an early stage of development. The ERP diagnostic points to

some key indicators: GDP per capita is around 20% lower than in Albania and Bosnia and Herzegovina, and less than half the level of Montenegro; one third of the population lives in poverty, and around 10% in extreme poverty. The cash benefits systems in place have a limited effect of alleviating poverty.

The socio-economic position of women is particularly weak. Women with lower than secondary education level are fully excluded from the labour market. Only women with tertiary education have higher employment levels (47.7%) than women on average, primarily in the public sector. A lack of childcare facilities and the two-shift school system, combined with low wage levels making part time work unattractive, hamper women's access to employment.

The ERP includes for the first time a reform measure in the area of social policy. The reform includes two distinct components. The building up of the health insurance fund based on contributions, already foreseen by legislation adopted in 2015, is now to start in mid-2017. Budgetary implications are substantial since contributions from public sector employees are covered by the state budget. New budgetary provisions are foreseen for funding social services to citizens at the local level that could support the inclusion of vulnerable and marginalised groups of the population. The government needs to ensure that this reform, which will establish new rights, especially in access to healthcare, is implemented in a sustainable manner and with tangible results for citizens.

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2016

2016 policy guidance	Summary assessment
<p>PG1: Improve forecast accuracy, enhance technical capacities of the services preparing the macro fiscal framework, strengthen parliamentary oversight capacities in evaluating budget planning and execution as well as fiscal risks and take first steps towards establishing an independent fiscal body.</p>	<p>There has been limited implementation of PG1:</p> <ul style="list-style-type: none"> • The Macroeconomics unit within the Ministry of finance, in charge of policy analysis and forecasting, is still understaffed and struggles with high turnover of personnel. • There have been some discussions between stakeholders on possible modalities for the establishment of the fiscal council/ institution but without any concrete actions.
<p>PG2: Identify offsetting measures for recent increases in categorical benefits while preserving the share of capital spending and address persistent under spending of the capital budget by improving project preparation and management capacities at central and local administration levels.</p>	<p>Kosovo has partially implemented PG2:</p> <ul style="list-style-type: none"> • Annual expenditure for the newly introduced categorical benefits has been limited to 0.7% of GDP. Furthermore the eligibility criteria for the scheme was strengthened and differentiated rates of benefits were introduced, with a view of finding additional savings. The government also committed to review the eligibility of all 48,000 certified war veterans as the original process was marred by transparency and credibility issues. • The share of capital spending was slightly increased in 2016 (26.8% compared to 25.8 in 2015). The 2017 budget foresees the ratio rising to 37.5% by 2019. • Overall 88.7% of the planned capital budget was executed. However this was done primarily due to the payment for the Route 6 highway project. There has not been any improvement in capital spending on the local level. Capacity constraints for public procurement and multi-year planning exist on both central and local levels as is evident from poor execution of planned spending under projects funded by IFIs.
<p>PG 3: Further address the underlying legal and institutional factors responsible for both high cost of credit and difficulties in access to finance so as to increase financial intermediation in the economy, while establishing a reliable measure of private sector inflation expectations so as to better gauge price developments.</p>	<p>Kosovo has partially implemented PG 3:</p> <ul style="list-style-type: none"> • Increased competition in the banking sector, reforms in the justice system and improvements in bank's loan portfolio contributed to credit growth and access to finance. A Credit Guarantee Fund aimed at facilitating access to finance by providing credit guarantees (up to 50%) was established in April 2016. • There has not been any reported progress on development of a reliable measure of private sector inflation
<p>PG 4: Implement the action plan of the strategy for the fight against the informal economy. In particular, speed up the risk assessments focusing on the sectors and branches most vulnerable to informalities in order to identify and apply appropriate corrective measures.</p>	<p>There has been limited implementation of PG 4:</p> <ul style="list-style-type: none"> • The Strategy implementation reports for 2015 and 2016 have been finalised and published after a 2-year gap in reporting. The Secretariat for Monitoring the Strategy Implementation has been reactivated and held several meetings. • Sectoral risk analyses have only been developed for the construction sector.
<p>PG 5: Increase energy security by reinforcing the planned energy efficiency measures to include</p>	<p>Kosovo has partially implemented PG 5:</p> <ul style="list-style-type: none"> • Energy efficiency: as of yet there is no

<p>incentives for the private sector and households and by adopting a plan for the gradual adjustment of energy tariffs to reflect actual costs</p>	<p>mechanism to finance or provide incentives to support energy efficiency investments in the private sector and households. There are no programmes for the renovation of residential buildings.</p> <ul style="list-style-type: none"> • Regarding the plan for gradual adjustment of energy tariffs: on 18 January 2017 the Board of the Energy Regulatory Office (ERO) adopted Guidelines for the liberalisation of electricity market in Kosovo. For some commercial consumers, the deregulation of prices will start in April 2017, while for the remaining large commercial consumers; the deregulation of prices will start in April 2018. The timelines for deregulation of prices for remaining consumers remains unclear,, although ERO has designed a tariff structure with some incentives for customers who save energy, thus starting to reflect the fact that marginal costs of supply are higher at peak time.
<p>PG 6: Set up an action plan for tackling youth unemployment based on an assessment of the challenges and focussing on improving education outcomes including through improved teacher training and supporting school-to-work transitions. Ensure that the Employment Agency has sufficient capacity. Take measures to increase labour market participation of women.</p>	<p>There has been limited implementation of PG 6:</p> <ul style="list-style-type: none"> • The Action Plan for tackling youth unemployment has not been developed (postponed to 2017). • Teacher training measures have been rolled out. • Internal regulations on the functioning of the Employment Agency have been drafted; however the full operationalization of the Agency is still depending on the nomination of its Director. • Apart from few active labour market measures with very small number of beneficiaries, no other measures to increase labour market participation of women have been taken so far.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The Economic Reform Programme 2017-2019 was adopted by the Government on 27 January 2017 and submitted to the Commission on the same day, ahead of the deadline. It is in line with the previously approved medium-term fiscal strategy and national development strategy. No components of the ERP are missing; however, no written contributions from external stakeholders have been annexed to the programme.

Inter-ministerial coordination

The preparation of the ERP was centrally coordinated by the Ministry of Finance with the support of the Office for Strategic Planning in the Office of the Prime Minister (OPM). The inter-ministerial coordination process improved this year and all relevant line ministries contributed to the drafting of the programme and were fully consulted. The ERP was discussed and endorsed by the Strategic Planning Committee chaired by the Prime Minister on 19 December 2016.

Stakeholder consultation

Section 6 of the ERP provides information on the public consultation of the ERP. A draft ERP was made available to the public on the OPM website in December 2016 and was emailed to a number of external stakeholders. A meeting was also held to discuss the draft, albeit very late in December during the holiday period, which did not facilitate participation. The draft was also presented to the Assembly of Kosovo for information and discussion. However, no written comments from stakeholders were annexed to the ERP.

Macroeconomic Framework

The presented macro-fiscal framework in the 2017 ERP is broadly plausible. External assumptions have been taken from the IMF October 2016 World Economic Outlook and the Commission's autumn 2016 forecast. Credibility of the fiscal framework has been greatly improved on the account of more conservative revenue projections. Both the low and the high growth alternative scenarios are useful to showcase the likely impact of some expected and unexpected developments in Kosovo's economy.

Fiscal Framework

The fiscal framework was prepared in cooperation with the IMF and is in line with the MTEF 2017-2019 and the 2017 budget. It envisages plausible revenue projections due to maintained growth. On the expenditure side the framework foresees a substantial fiscal expansion through higher investments. However, risks of capital under-spending and further ad-hoc increases of current spending remain.

Structural reforms

The structural reforms sections (4, 5 and 6) follow the guidance note. The reporting of the implementation of the policy guidance (sections 1 and 4) and the structural reform measures from the 2016-2018 ERP (table 12 in annex) is both sufficient and up-to-date. The number of reform measures is limited to 20 and the page limit (40) for section 4 is respected. The structure of the reform measures is much improved, in terms of scope and clarity of timeline and budget for activities planned in the three years of the programme. Tables 9-12 of the annex are filled in appropriately.