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From: General Secretariat of the Council

To: Delegations

Subject: Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye

Delegations will find attached the text of the Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye as approved by the participants of the Dialogue on 16 May 2023.

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

**The Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye, Brussels, 16 May 2023**

Representatives of the EU Member States, the Western Balkans and Türkiye, the European Commission and the European Central Bank, as well as representatives of the central banks of the Western Balkans and Türkiye met for their annual economic policy dialogue. The dialogue aims to prepare the future participation in the European Semester of the Western Balkans and Türkiye (Montenegro, the Republic of Serbia, the Republic of North Macedonia, the Republic of Albania, Bosnia and Herzegovina, and the Republic of Türkiye are candidate countries for EU accession, while Kosovo\* is a potential candidate).

The economic impact of Russia’s war of aggression against Ukraine has confronted EU Member States, the Western Balkans and Türkiye with major economic and social challenges. Participants agreed that the economic policy dialogue is of high importance in view of a common interest to define appropriate policy responses also to the recent adverse shocks. Participants emphasised the common position by the EU and the Western Balkans and Türkiye in deploring in the strongest terms the continued military aggression by the Russian Federation against Ukraine. In view of high uncertainty about potential further impacts of Russia’s war against Ukraine, participants considered it appropriate to stand ready to mitigate, if needed, adverse impacts on growth, employment and social cohesion by adequately targeted, temporary and transparent fiscal and financial measures while keeping an appropriately tight fiscal stance in 2023 and beyond to help lower persistent high inflation and preserve fiscal sustainability. Confronted with growing instability, strategic competition and security threats, the EU has taken more responsibility for its security and has taken further decisive steps towards building European sovereignty, reducing dependencies and building a more robust economic base to support a sustainable, resilient, competitive and inclusive Europe. Participants agreed that these objectives are also relevant for the Western Balkans and Türkiye and recommitted to the economic and financial dialogue as it contributes to the wider goals of good governance, including the rule of law, and economic prosperity. In order to strengthen economic resilience in the longer term, all participants committed to accelerating the green and digital transition of the Western Balkans and Türkiye in line with commitments related to targets for greenhouse gas emissions reduction, energy efficiency and renewable energy for 2030. They also recall the importance of enhancing human capital development and social inclusion, particularly of young people. This should be supported by the appropriate and efficient use of EU financial support through the Instrument for Pre-accession and the European Fund for Sustainable Development Plus.

Participants underlined that the earthquakes of 6 February 2023 in Türkiye represent, first and foremost, a very large humanitarian crisis, and expressed solidarity with Türkiye. While the full economic impact of the earthquake is yet to be assessed, participants agreed that the amount of losses and the reconstruction costs will require the mobilisation of very substantial financial resources. As such, participants underlined that this year’s Economic Reform Programme assessment, which is based on a set of assumptions preceding the earthquakes, would need to be read in conjuction with Türkiye’s revised priorities following these events.

**\*** 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.

Looking beyond the current challenges, participants agreed that the economic policy dialogue should continue to play a central role in providing jointly agreed policy guidance to support a sustainable medium-term economic recovery and help the enlargement partners to gradually meet the economic criteria for EU accession. Participants underlined their commitment to this economic and financial dialogue and encouraged the Western Balkans and Türkiye to fully implement the macro-fiscal and structural policies and reforms as outlined in their programmes to foster a sustained recovery. Participants emphasised that ownership will be key to a successful implementation of the jointly agreed policy guidance. Participants welcomed the Progress report on the action plan on economic, monetary, and financial statistics for the Western Balkans and Türkiye and appreciated its high quality. Participants regretted that Bosnia and Herzegovina’s Economic Reform Programme had again been submitted with a significant delay. The dialogue will continue in 2024, including on the implementation of these conclusions and will be extended to Ukraine, Moldova and Georgia**1**.

**1** On 23 June 2022, the European Council granted the status of candidate country to Ukraine and to the Republic of Moldova and recognised the EU membership perspective of Georgia.

# Montenegro

Montenegro submitted its Economic Reform Programme 2023-2025 on 25 January 2023. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 24 May 2022 has been implemented to a limited extent.

Helped by strong tourism exports and surging private consumption, Montenegro’s economy expanded by double-digits in the first half of 2022 but started to decelerate in the later months of the year. The baseline scenario set out in the ERP projects real GDP growth to slow to an average of 4% in 2023-2025 and to be driven by a continued recovery in tourism, a strong increase in investment and decelerating but still positive private consumption growth. The balance of risks is tilted to the downside as domestic political instability and higher financing costs could negatively affect investment; slowing growth in trade partners could dampen tourism exports; while risks related to the fallout from Russia’s war against Ukraine could result in further increases of energy and food prices, eroding disposable income. Imports may increase by more than expected if investment plans are realised.

Recent measures, including a decision to abolish health contributions, weakened the revenue base and, together with a number of new, mostly permanent increases in mandatory spending, resulted in a significant increase in the deficit target in the revised 2022 budget, to more than 8% of GDP. However, the actual outcome was lower at below 5% of GDP as high inflation and strong real growth boosted indirect revenue while spending on investment and wages was lower than budgeted. Absent any consolidation measures, the ERP projects the budget deficit at some 6% of GDP in 2023-2025, implying a pro-cyclical fiscal stance, and public debt to stabilise at a high level of close to 75% of GDP.

Debt repayment needs are set to increase sharply, especially in 2025, which, coupled with tightening financing conditions, raises vulnerabilities and calls for a more prudent fiscal position. Fiscal sustainability needs to be enhanced by a medium-term plan based on specific consolidation measures. Broadening the tax base, streamlining tax exemptions and incorporating new budget revenue initiatives to offset recent revenue-decreasing measures would contribute to rebuilding fiscal space and reducing public debt. Strengthening the long-term sustainability of public finances requires improvements in fiscal governance and public investment management. New expenditure initiatives have been adopted without properly assessing their fiscal implications. Large infrastructure projects need better management and prioritisation in light of the very limited fiscal space available. Following up on plans to set up an independent fiscal institution would contribute to strengthening fiscal governance and discipline.

Inflation has accelerated to reach a peak of 17.5% in November 2022, driven mainly by imported food price inflation, and has been slowly declining since then. Under the chosen monetary framework, limiting the scope to address inflationary pressure, fiscal restraint is essential to contain risks that inflation gets entrenched at elevated levels. The banking sector has remained sound. On the back of the economic recovery, key financial stability indicators improved. An influx of liquidity driven by deposits in 2022 also supported private credit growth. The banking system enjoys adequate capital buffers and profitability. It remains important to continue to strengthen the forward-looking monitoring of banks’ asset quality and ensure sufficient provisioning, following the completion of the Asset Quality Review in 2021. The authorities have also made progress in financial sector reforms, including in advancing key legislations such as the Law on Credit Institutions and the Law on Resolution of Credit Institutions that align Montenegro's regulation and supervision with the EU framework. A more comprehensive assessment of risks is hampered by data availability, in particular as regards real estate statistics. Progress could be accelerated to strengthen the broad legal, judicial and regulatory framework, which requires inter-ministry collaboration outside the mandate of the central bank to expedite the resolution of non-performing loans.

Political stability and resolve will be decisive to maintain economic resilience, supported by the effective use of the IPA funds and implementation of the Economic and Investment Plan for the Western Balkans. It will also be critical to boost inclusive growth, increase competitiveness and job creation and accelerate the transition to a greener and more digital economy, while ensuring fiscal sustainability and working towards alignment with the EU acquis. This should be underpinned by intensified, substantial efforts to tackle structural reforms in key areas, including to address corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

The three specific structural reform areas in terms of boosting competitiveness and long-term and inclusive growth in Montenegro are: (i) strengthening the regulatory environment, (ii) reducing informality in the economy and (iii) increasing employment, in particular of women and young people and tackling long-term unemployment.

The authorities should focus on making the regulatory environment more business-oriented. This includes further fostering the digitalisation of public administration and developing e-government services, while stepping up the cybersecurity of the public IT infrastructure. The green transition, and preparation for the introduction of Carbon Border Adjustment Mechanism (CBAM), needs to be incorporated and mainstreamed by the government. There is an urgent need to reform the management framework and oversight of the State-Owned Enterprises in line with the best European practices to improve their performance and limit fiscal risks. Continuous dialogue and cooperation, involving state, local administration, businesses and civil society partners remains instrumental.

A clear vision, political lead and good cooperation between business, civil society organisations, social partners, state and local authorities is also needed to break the current pattern of nominal progress and erratic implementation of reforms aimed at reducing the size and scope of the informal economy. A comprehensive action plan to reduce informality is yet to be formulated and clear reforms and actions need to be prepared and implemented on its basis.

While with the economic recovery from the COVID-19 crisis the labour market indicators have improved and some are surpassing pre-crisis levels, persistently low activity and high unemployment rates, especially among women, young people and the low-skilled and high long- term unemployment remain a structural challenge. The rate of young people not in employment, education or training remains high and shows no sign of recovery from the crisis. Montenegro is expected to adopt the Youth Guarantee Implementation Plan to address the situation in early 2023. Skills mismatches remain an obstacle to transitioning into employment. The improvement of the effectiveness of active labour market measures, their monitoring and therefore evidence-based design, and effective delivery remain lacking. Coordination between employment and social services recorded limited progress and therefore disincentives to work persist. The progress in strengthening social dialogue seen in 2021 remains. Efforts of the government to improve the broader innovation ecosystem have taken a step forward with the establishment of the Innovation Fund.

Participants welcome that Montenegro reached a milestone achievement in the publication of harmonised indices of consumer prices. Data gaps remained in national accounts, R&D, labour market statistics, short-term business statistics and balance of payments. Montenegro needs further alignment with new requirements in short-term business statistics, and monetary and financial statistics need further attention. Montenegro should also give priority to the transmission of excessive deficit procedure (EDP) notifications and government finance statistics (GFS) as Eurostat is, at this stage, unable to assess their compliance given that no data is transmitted for GFS and very few data were transmitted for EDP in the past.

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

1. Adopt an appropriately tight fiscal stance in 2023 to help disinflation, while providing targeted support to vulnerable households and firms, if needed. Adopt a new medium-term fiscal strategy with the 2024 budget, including concrete consolidation measures supporting the achievement of a non-negative primary balance from 2025, and a reduction of the public debt ratio over the medium-term. Ensure proper costing of new fiscal initiatives before considering them for adoption.
2. Implement the public investment management assessment (PIMA) recommendations, prioritising key public infrastructure works within the available fiscal space while avoiding exceptions regarding project selection. Adopt the planned amendments to the Law on Budget and Fiscal Responsibility and take concrete steps towards setting up a fiscal council. Based on an analysis of the economic and fiscal impact of all tax expenditures to be shared with the Commission, prepare concrete budgetary recommendations to reduce tax expenditure (such as exemptions, deductions, credits, deferrals).
3. Continue to carefully assess and analyse price developments, stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality and continue to reduce data gaps in particular as regards the real estate sector. Continue to improve and implement legislations to further align with the EU framework on regulation and supervision, including on deposit insurance, and accelerate efforts to provide viable and timely solutions for swift and effective NPL resolution.
4. Improve the institutional and regulatory environment and enhance energy resilience and transition to implement the Green Agenda. Further digitalise and simplify administrative procedures for micro, small and medium enterprises and prioritise cybersecurity, data protection and business continuity for e-government services. Prepare a roadmap for reforming state-owned enterprises (SOEs), prepare a framework for the monitoring and management of SOEs and develop objective criteria for the selection of their management bodies.
5. Based on the results of the informal economy survey, establish an action plan to reduce informality. Ensure cooperation between central and local authorities to implement the plan, including prevention and incentives to legalise informal businesses and employees. Develop an analysis of the inspection services and of the relevant legal framework to optimise the inspector’s work, minimising discretionary decisions and inconsistences in the inspection powers.
6. Prepare activities for the implementation of the Youth Guarantee pilot planned for 2025, analyse its performance, and in parallel identify and implement necessary structural, operational and organisational changes to ensure that the Employment Agency of Montenegro is prepared for the service delivery of the fully-fledged Youth Guarantee as well as its other functions. Continue efforts to reform the provision of active labour market policy measures with an emphasis on their labour market relevance, including work-based learning, and establish a continuous monitoring mechanism that will enable evidence-based active labour market policy design. Based on the Roadmap of reforms on social assistance and social and child protection services in Montenegro, establish a clear timeline and financial planning for the reform of the social and child protection system and start implementing the reforms.