# KOSOVO

## Highlights

- **Growth has slowed and a recession is expected in 2020.** After growing by 4.2 per cent in 2019, the economy contracted by 4.8 per cent year-on-year in the first half of 2020 due to a severe drop in investment and exports.
- **The government adopted an emergency relief package.** The package, adopted in April 2020, supports employment, municipalities and people in need, and has since been followed by a medium-term economic recovery package and a plan for implementing the latter.
- **Kosovo removed the 100 per cent tariff imposed on goods imported from Serbia and Bosnia and Herzegovina.** Also, the requirement of "reciprocity", including requesting the use of the name of the Republic of Kosovo on documents on imported goods, has been withdrawn.

## Key priorities for 2021

- **Governance and economic performance of state-owned enterprises (SOEs) should be improved.** Updating the state ownership policy, clarifying further the responsibilities of the board of directors and improving the legal and institutional framework for measuring and monitoring SOE performance can help raise their economic performance, which was weak even before the pandemic and has worsened further since then. Also, the new Law on Publicly Owned Enterprises should be adopted.
- **Acceleration of reforms in the business environment would enable a swifter recovery.** Decreasing the (widespread) informality and tax evasion, which would also facilitate access to finance for small and medium-sized enterprises (SMEs), could improve the growth outlook.
- **Raising competitiveness and economic diversification through smart specialisation is warranted.** This would enable the economy to build further capacity and enhance the value-added content of exports. In addition, accelerating sustainable investments in infrastructure and energy would enable Kosovo to speed up its green transition.

Main macroeconomic indicators %

| | 2016 | 2017 | 2018 | 2019 | 2020 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.1 | 4.2 | 3.8 | 4.9 | -5.0 |
| Inflation (average) | 0.3 | 1.5 | 1.1 | 2.7 | 0.3 |
| Government balance/GDP | -1.7 | -1.4 | -2.9 | -2.8 | -7.0 |
| Current account balance/GDP | -7.9 | -5.4 | -7.6 | -5.5 | -6.0 |
| Net FDI/GDP [neg. sign = inflows] | -2.9 | -3.3 | -3.4 | -2.9 | -3.0 |
| External debt/GDP | 33.2 | 32.6 | 30.3 | 31.0 | n.a. |
| Gross reserves/GDP | 10.0 | 10.7 | 11.4 | 12.2 | n.a. |
| Credit to private sector/GDP | 36.5 | 38.6 | 40.8 | 42.5 | n.a. |

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## Covid-19: macroeconomic implications

**The solid economic growth of previous years has disappeared because of the pandemic.** GDP grew by 4.2 per cent in 2019, driven by investment and consumption. Strong exports (at over 10 per cent) and subdued imports growth (below 5 per cent) helped reduce the current account deficit from close to 8 per cent of GDP in 2018 to below 6 per cent in 2019. Higher growth in 2019 resulted in some employment gains, as the employment rate increased in 2019 by one percentage point (to 30 per cent). Despite falling somewhat, the unemployment rate stayed high, at 25.7 per cent, especially for youth (49.4 per cent). With the onset of the pandemic, the economy contracted by 4.8 per cent year-on-year in the first half of 2020. Investments and exports declined sharply, by 28.3 and 21.0 per cent year-on-year, respectively. Available figures for the second quarter show that manufacturing output declined by 16.9 per cent year-on-year and was accompanied by a fall in the number of employees in the sector (3.3 per cent year-on-year).

**Inflation has slowed in 2020.** Inflation in 2019 picked up to 2.7 per cent from 1.1 per cent in 2018. Prices, especially those of food, rose significantly, possibly reflecting the imposition of a 100 per cent tax on goods imported from Serbia and Bosnia and Herzegovina in November 2018. However, year-on-year inflation started to decelerate from the second half of 2019, dropping below zero in July 2020, in part due to the negative demand effects of the lockdown measures.

**The fiscal stance is being loosened significantly.** Budgetary revenues, especially taxes, are on track to fall by more than 10 per cent in 2020, as household and corporate revenues decline. Expenditures may stay constant but the internal structure is set to change, with current spending (mostly subsidies and grants to companies and individuals) increasing and capital spending decreasing. As a result, the overall fiscal deficit is forecast to rise to 6.5 per cent of GDP (according to the amended 2020 budget) from 2.8 per cent in 2019. Public debt may increase from below 18 per cent of GDP in 2019 to close to 21 per cent in 2020. The additional public financing needed is mainly covered by funding from international institutions, including the International Monetary Fund (IMF) and the European Union.

**A relatively fast recovery is possible.** After a forecast recession of -5.0 per cent in 2020, a rebound of 4.0 per cent GDP growth is expected in 2021, with domestic demand continuing to be the main growth driver. The risks to the projection are on the downside as the pandemic and associated economic disruption may last longer than expected. Further risks are in the weak public investment management and the potential slow recovery of European Union (EU) countries and main trading partners. Regarding the former, a swifter recovery would be helped by the acceleration of the hitherto-slow implementation of key infrastructure projects.

## Policy response to Covid-19

**The government has put in place a Covid-19 emergency relief package.** The package, adopted in April 2020, amounted to nearly €180 million (more than 2.5 per cent of GDP). The measures included support to affected sectors through liquidity provision, wage subsidies and corporate and personal income tax deferrals. Health expenditures were also increased, as well as assistance to socially vulnerable people (for example, double payment of the value of the social assistance for three months, and monthly assistance to vulnerable groups and those who lost their job for two to three months). In addition, the package envisaged the provision of interest-free loans to publicly owned enterprises (with a maturity period until the end of 2020) and financial support to municipalities. Companies could benefit from support to salaries of €170 per month, lasting for two months, and to pension contributions, and SMEs became entitled to a rent subsidy of up to 50 per cent of the rent value. Micro enterprises and the self-employed could receive credit guarantees through the Kosovo Credit Guarantee Fund of up to €10,000. Grants and subsidies to increase agricultural production and to support exporters and sports and cultural activities have also been envisaged. Furthermore, the central bank allowed the submission of loan restructuring applications until the end of September 2020 for borrowers with payment difficulties due to the pandemic.

**The government has adopted a medium-term economic recovery package.** The new package, adopted in June 2020, is worth €1.2 billion and covers the period 2020-23. The package aims

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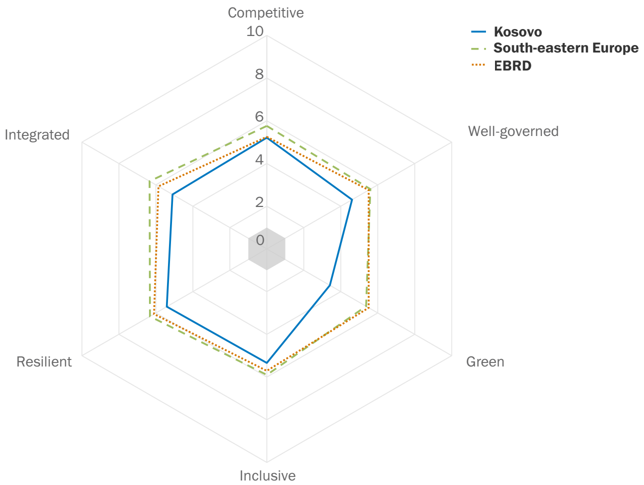
to facilitate access to finance, reduce the tax burden, and support employment in the agriculture sector and public enterprises. In August 2020 it was followed by a plan to implement the package, totalling €365 million. The plan contains 15 measures and among other things envisages supporting the Kosovo Credit Guarantee Fund, covering the minimum operating costs of publicly owned enterprises and providing financial support for youth employment.

**Kosovo is receiving significant international assistance to help cope with the Covid-19 crisis.** Since the outbreak of the pandemic, the EU, the IMF and other international financial institutions provided special assistance to finance the additional costs of the pandemic. The Macro-Financial Assistance from the EU amounted to €100 million, while the IMF's Rapid Financing Instrument was €51.6 million. Other international organisations and some countries also offered financial support to the country.

Assessment of transition qualities (1-10)




## Structural reform developments

**There has been little progress in EU accession negotiations over the past year.** Kosovo signed the Stabilisation and Association Agreement (SAA) with the EU in October 2015 and it formally entered into force on 1 April 2016. While the European Commission has repeatedly stressed that Kosovo shares the European perspective of the Western Balkans, the question of its integration into the EU remains contentious due to the fact that five member states do not recognise Kosovo bilaterally. Although the European Commission confirmed that Kosovo fulfilled outstanding visa liberalisation benchmarks, the decision for visa liberalisation is pending in the European Parliament and the council, and citizens of Kosovo remain the sole among Western Balkans countries unable to travel without a visa to the Schengen area.

**The 100 per cent tariff on goods from Bosnia and Herzegovina and Serbia has been revoked.** The government of Kosovo originally introduced the tariff in November 2018 as a response to what it called Serbia's "aggressive campaign" to revoke Kosovo's international recognition. In April 2020 the previous government revoked the 100 per cent tariff imposed on goods imported from Bosnia and Herzegovina and Serbia, but imposed reciprocity measures from May, consisting of trade restrictions and customs requirements. This included requesting the use of the name of the Republic of Kosovo on documents on agricultural and industrial products, as well as an entry permit for vehicles transporting goods to Kosovo from the Liaison Office of the Republic of Kosovo in Serbia. In June 2020 the incoming new government revoked the reciprocity measure.

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**Kosovo has joined the newly formed Kosovo-Albania Control Block within the European transmission network.** Accession to the network took place in May 2020. Kosovo has left the SMM (Serbia, Montenegro and North Macedonia) block. This formation of a new link with Albania may increase electricity transmission between the two countries and improve the stability of supply. On the green agenda, work has now started in cooperation with the Energy Community to introduce an auctions scheme to allocate licences for renewables as a successor to feed-in tariffs.